Equity Research
March 29, 2012
BSE Sensex: 17122

INDIA

ICICI Securities

Infrastructure Finance Companies

In fear lies opportunity

Reason for report: Initiating coverage

Power Finance Corporation (PFC) and Rural Electrification Corporation (REC) have underperformed the NIFTY by 22% and 12% YoY respectively. However, fears that had sent valuations crashing to 0.8x (for PFC) and 0.9x (for REC) 12-month forward ABV still persist. Tariff hikes precipitated by financiers' aggression and positive steps taken *inter alia* by APTEL and the PMO signify remedial processes are underway to resolve the crisis. In our view, given that the various stakeholders (government, CIL, APTEL, lenders, etc.) have much to lose by allowing PFC and REC to fail, it is unlikely that their exposure to SEBs will deteriorate into NPAs. Note that in case of a net worth impairment in either PFC or REC: i) the government will anyhow have to recapitalise them because they are state-owned lenders, and ii) failing to recapitalise will undermine the government's creditworthiness. Exposure to private sector projects may not receive the same favours though. However, both PFC and REC have low private sector exposure, which restricts asset risks. We therefore expect both PFC and REC to trade at ~1.3x FY13E ABV (a discount to its 5-year average ABV multiple of ~1.6x) with RoAs of 2.7 / 3.1% and RoEs of 18 / 21% respectively. We initiate coverage on PFC (BUY) and REC (ADD) and prefer PFC for its lower risk profile.

Initiating Coverage

PFC (Rs172 – BUY)
Target price Rs222

REC (Rs196 – ADD)
Target price Rs217

- **Asset risks only in pockets, not across exposures.** We believe PFC and REC's asset risks lie predominantly in their IPP exposures, concentrated in the under-construction generation projects. Most of these IPP projects are currently facing delays due to lack of environmental clearance, FSAs and PPAs. One could foresee restructuring/slippage in these projects. While risk of SEB default is quite low, the possibility of restructuring loans to them exists; hence we also differentiate between PFC and REC based on their SEB exposures. Of the exposure to SEBs, PFC has ~85% of it to states with unbundled SEBs and 49% to states with the top-9 loss-making SEBs. Its asset book is relatively less risky than that of REC where the corresponding numbers are 71% and 60%.
- **Outstanding sanctions will help sustain business/earnings momentum.** Outstanding sanctions will lead to a healthy disbursement momentum of 18-20% YoY, leading to a loan CAGR of 19% over FY12-FY14E for PFC and 18% for REC. This coupled with average spreads of 2.4% and 3.3% for PFC and REC respectively, is likely to result in healthy RoAs of 2.7% / 3.1% and an earnings CAGR of 20% / 18% for PFC / REC respectively over FY12-14E.
- **As reforms take shape, multiples will approach ~1.3x FY13E ABV.** PFC and REC stock prices have corrected from peak valuations of 2.6x and 2.8x 1-year forward P/ABV on persistent negative newsflow from the power sector. Current valuations of 1.0x / 1.2x respectively seem to have factored-in the recurring bad news. Incrementally, an overhang of tardy reform will keep trading multiples below long-term averages. However, given their profitability profiles, we estimate 12-month fair value multiples of ~1.3x FY13E ABV (a discount to 5-year average P/ABV of ~1.6x) for both. Initiate coverage on **PFC (BUY)** and **REC (ADD)**.

Abhishek Murarka
abhishek.murarka@icicisecurities.com
+91 22 6637 7351
Shashin Upadhyay
shashin.upadhyay@icicisecurities.com
+91 22 6637 7572
Digant Haria
digant.haria@icicisecurities.com
+91 22 6637 7314

Valuation summary

	Reco	CMP (Rs)	Target price (Rs)	P/E (x)		P/ABV (x)		RoE (%)	
				FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
PFC	BUY	172	222	6.1	5.1	1.0	0.9	17.1	18.0
REC	ADD	195	217	5.7	5.0	1.2	1.0	21.5	21.8

EPS, RoA and RoE are calculated on recurring profits; Source: I-Sec research

Please refer to important disclosures at the end of this report

TABLE OF CONTENTS

Asset risks in pockets only, not across exposures 3
Risk snapshot I – State/Central/Joint Sector exposures 3
Risk snapshot II – Under construction power projects 6
PFC: Various hues in the loan book, not all red 8
REC: Riskier loan book given high T&D exposure 9
Business momentum to drive healthy earnings 11
Sanction pipeline robust, downside risks to growth remain 11
Borrowing profile well diversified, costs to trend lower 12
Spreads to sustain at healthy levels 14
In sum, earnings growth and profitability will remain healthy 14
Play for re-rating on positive developments 16
Valuations and view 16
V.K. Shunglu Committee report – Do not expect fast-track execution 20
What this means for term lending institutions 21
Key risks 22

COMPANIES

Power Finance Corporation 25
Rural Electrification Corporation 33

Note: Prices and Sensex as on March 28, 2012 unless otherwise mentioned

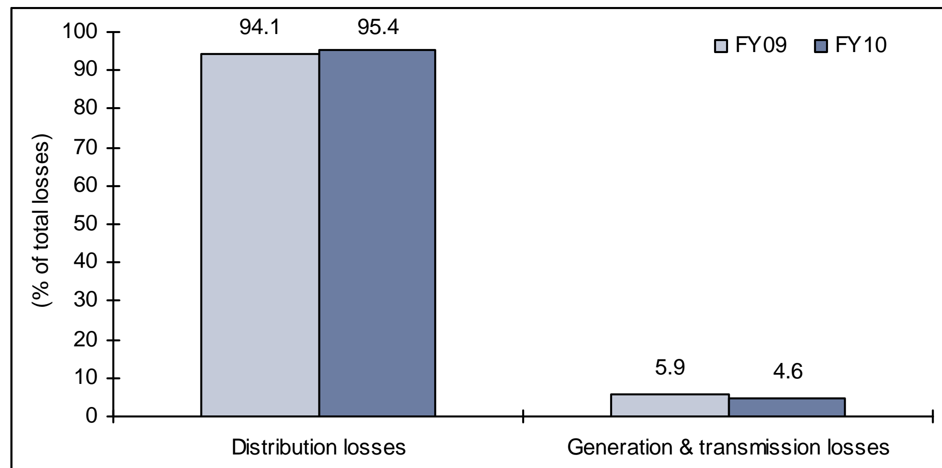
Asset risks in pockets only, not across exposures

Asset risk for power financiers evidently lies in their exposure to IPPs and in the working capital loans given to SEBs (the quantum of which is very little for PFC and REC). Facility-wise NPA recognition for SEBs might ensure that NPAs, if any, are not as chunky as one generally assumes in the worst case. While risk of SEB default is quite low, the possibility of restructuring loans to them is real; hence we also differentiate between PFC and REC based on their SEB exposures. To us, PFC is the less risky proposition because: i) it has higher proportion of loans to unbundled SEBs, primarily in generation, ii) its exposure to the transmission and distribution sector as of Dec-11 is minimal at 12.1% while REC has a larger 49.2% exposure to this space. Vulnerability is high for loans to IPPs (9.8% for PFC and 12.0% for REC as of Dec-11) as there is no 'bailout' option.

Risk snapshot I – State/Central/Joint Sector exposures

Losses are concentrated on the distribution side of SEBs. Discoms accounted for 95.4% of total losses in FY10

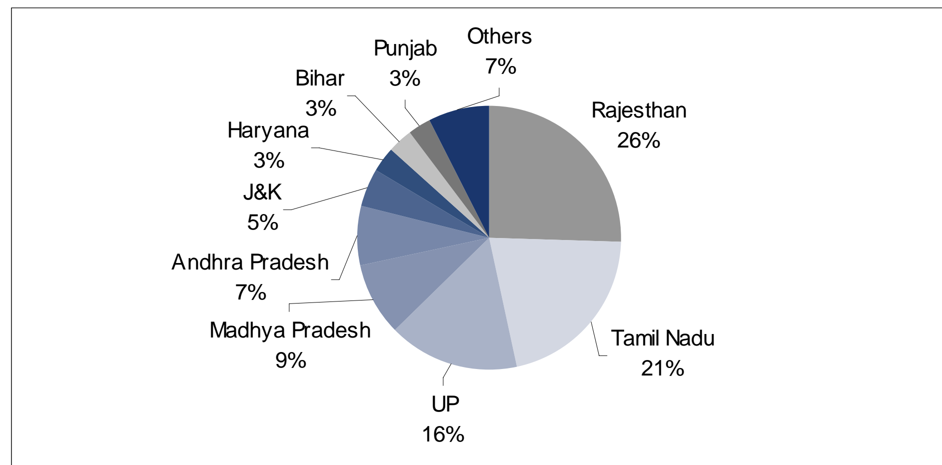
Chart 1: State Electricity Boards' losses are concentrated in discoms



Note: Distribution losses include losses of bundled SEBs
Source: PFC report on State Power Utilities.

Top 9 states with major contribution to SEB losses account for 93% of total system losses and 96% of net system losses

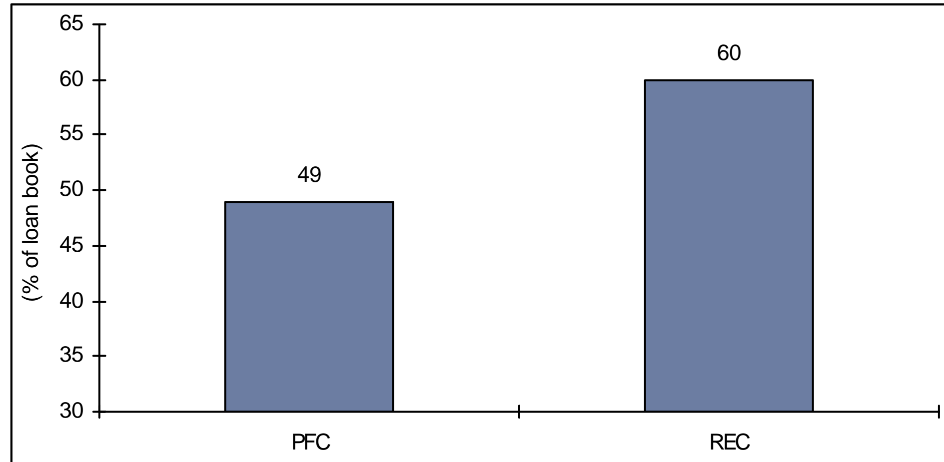
Chart 2: States with high contribution to SEB losses



Source: PFC report on State Power Utilities.

States with top-9 loss making SEBs account for 96% of countries net SEB losses as of FY10. PFC has lower exposure to such states

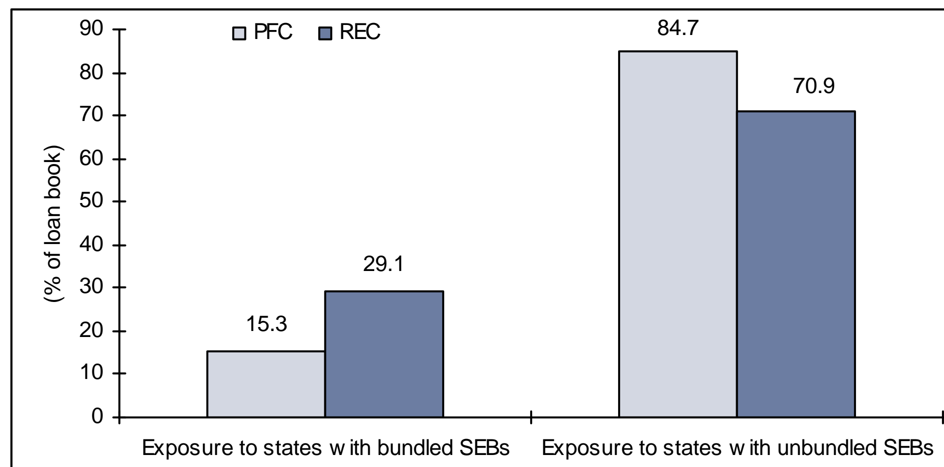
Chart 3: Exposure to States* with Top-9 loss making SEBs



*Profit/loss data for States as of FY10
*Cumulative exposure to State, Joint and Private Sector as of Mar-11
Source: Company data, PFC report on State Power Utilities.

Exposure to bundled SEBs pose a higher risk as demarcation between generation, distribution and transmission is thin. PFC has lower exposure to such states

Chart 4: Exposure to States* with bundled SEBs



*Cumulative exposure to State, Joint and Private Sector
Source: Company data, PFC report on State Power Utilities.

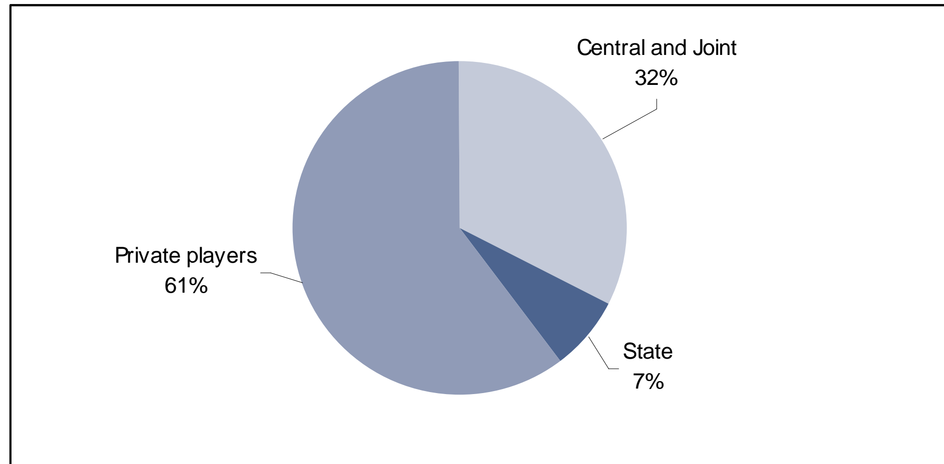
Table 1: State Electricity Boards* – Key financials as of FY10

		% exposure to States (Mar-11)		Funding profile (Rs bn)			Rs / kwh			Profitability (Rs bn)		
Key states	**SEB status**	**PFC**	**REC**	**Net worth**	**State govt. loans**	**Loans from FIs, banks**	**ACS**	**Gap (without subsidy)**	**Gap (subsidy booked)**	**Profit (without subsidy)**	**Profit (subsidy received)**	**Tariff hikes**
Maharashtra	Unbundled	12.8	17.0	95.7	8.0	227.5	3.5	0.1	0.1	(10.4)	(6.4)	Largest power-consuming state and accounts for ~15% of country's demand. MERC has approved 10% tariff hike for MSED in Nov'11.
Rajasthan	Unbundled	8.8	11.0	74.1	16.2	456.2	4.9	2.7	-	(127.2)	(118.5)	The largest loss-making state in India. Announced 20% tariff hike in Sep'11. Losses expected to narrow.
Haryana	Unbundled	8.6	6.5	11.1	1.0	213.5	4.1	1.4	0.5	(47.0)	(14.6)	Heavy subsidisation for agriculture segment. Latest tariff hike of 1% happened in Aug'11.
Andhra Pradesh	Unbundled	8.5	10.4	58.3	4.4	253.9	3.3	0.9	(0.0)	(62.9)	(32.8)	Has petitioned for 21% rate hike. Have not taken any major hike in past nine years.
Uttar Pradesh	Unbundled	8.1	8.4	91.3	19.3	247.7	3.6	1.3	0.9	(93.6)	(75.4)	Last tariff revision happened in Apr'10 when it was increased by 13%.
West Bengal	Unbundled	8.0	6.4	83.0	63.0	73.6	3.2	(0.0)	(0.0)	2.7	2.7	Regular tariff hike seen. Announced 10% hike in Jan'12.
Madhya Pradesh	Unbundled	7.4	2.5	(17.1)	39.3	104.9	3.6	1.2	0.9	(51.7)	(40.8)	Announced 6% tariff hike in July'11.
Delhi	Unbundled	6.9	0	44.1	6.8	68.2	4.3	(0.2)	(0.2)	9.2	9.2	Announced 22% tariff hike in Aug'11.
Tamil Nadu	Bundled	5.6	13.5	(227.3)	-	320.4	4.1	1.6	1.4	(113.5)	(96.8)	Worst-affected SEB. Has hiked tariff only by 9% in past seven years. Has applied to TNERC for 40% tariff hike in Nov'11.
Uttarakhand	Unbundled	4.4	3.0	(6.0)	11.1	19.5	3.1	0.5	0.5	(4.2)	(4.2)	Tariff hiked by 7% in Apr'10
Gujarat	Unbundled	4.1	0.4	108.1	8.6	133.5	3.2	0.2	(0.0)	(8.4)	2.7	4% tariff hike in Sep'11.
Chhattisgarh	Unbundled	4.1	2.8	32.7	4.4	30.9	2.1	0.2	0.2	(4.3)	(4.3)	Regular tariff hike since Jan '10. Latest hike of 14% happened in Apr'11.
Jharkhand	Bundled	3.1	1.9	(53.6)	63.0	7.9	3.4	1.2	0.8	(11.1)	(7.1)	No tariff hike from 2003 to 2010. Announced 19% tariff hike in July'11.
Himachal Pradesh	Bundled	2.9	1.8	(1.1)	11.5	28.1	3.9	0.2	0.2	(1.5)	(1.5)	12% tariff hike in July'11.
Punjab	Bundled	0.4	6.8	(68.3)	11.6	161.8	3.3	1.1	0.3	(44.5)	(13.0)	9% tariff hike in May'11.
J&K	Bundled	1.3	0.8	(99.3)	20.2	26.7	2.9	2.0	2.0	(21.8)	(21.8)	
BIhar	Bundled	0.3	0.6	(45.3)	112.5	13.6	4.1	2.2	1.4	(22.5)	(14.1)	
Others		4.9	6.3	66.6	39.1	243.1				(22.5)	(7.5)	
Total		**100**	**100**	**147.0**	**439.9**	**2,630.7**				**(635.1)**	**(444.3)**	

*Includes only discoms in case of states with unbundled SEBs
Source: PFC report on State Power Utilities, I-Sec Research

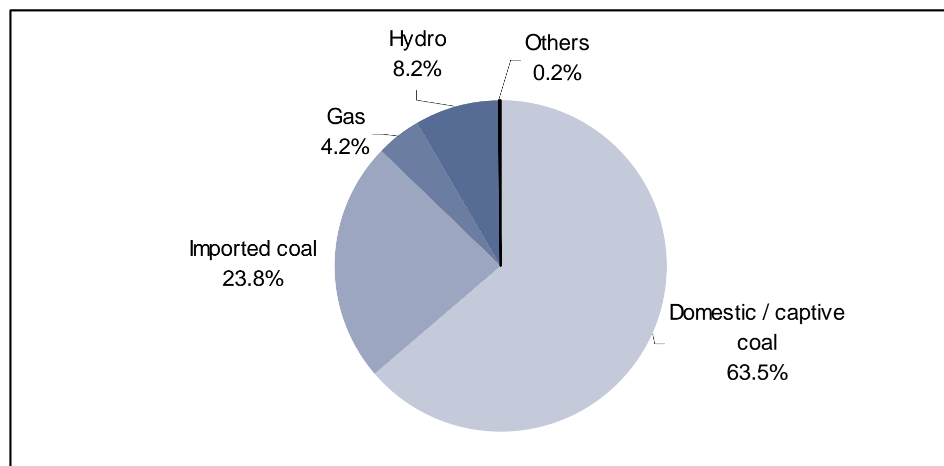
Risk snapshot II – Under construction power projects

Chart 5: Break-up of power projects (total = ~281GW) currently under-construction



Source: Company data, Media sources, I-Sec research

Chart 6: Fuel based break-up of power projects currently under construction (total = ~137GW) for top 20 private players



Source: Company data, Media sources, I-Sec research

Table 2: A snapshot of private power projects in India

	Under construction (MW)	Gas (MW)	Domestic/ Captive coal (MW)	Imported coal (MW)	Hydro (MW)	Plants	Comments
Adani	10,890	-	5,280	5,610	-	Dahej,Kawai, Mundra II, Mundra III, Mundra IV, Tiroda -I and II, Tiroda -III	Unviable PPAs, dependence on merchant and imported fuel. Availability of domestic fuel uncertain.
Adhunik Power	4,260	-	4,260	-	-	Bhagalpur, Janjgir Champa, Kandra, Saraikela I, Saraikela II	Saraikela to be commissioned shortly, could face coal problems
Asian Genco	3,940	-	-	2,640	1,300	Kakarapalli, Malana II, Teesta III	Environmental issues could delay its 2640MW thermal project, scheduled to start in 2013.
Avantha Power	2,400	-	2,400	-	-	Raigarh, Seoni	Both the plants are scheduled to commence operations in 2013. No reported delays
CESC	4,720	-	4,520	-	200	Chandrapur (Dhariwal), Haldia I, Dumka, Dhenkanal, Pirpainti, Bikaner	Fuel availability for near term projects should improve post signing of FSAs. New plants yet to see implementation
Essar Power	10,250	380	6,570	3,030	-	Salaya III, Mahan I & II, Tori II, Paradip, Neptune I, Neptune II, Vadinar, Salaya I, Salaya II, Tori I, Vadinar, Hazira II	Projects under various stages of implementation; delay in clearances to its coal blocks could delay commencement
GMR	7,648	768	2,000	2,740	2,140	Kamalanga, Warora (EMCO), Raipur, Shahdol (SJK), Vemagiri(Expansion), Badrinath - Alaknanda, Talong, BajoliHoli	Gas availability issues to delay Vemagiri; Other thermal projects to be commissioned over 2013-15
GVK	2,441	1,200	540	-	701	Goindwal Sahib, Gautami II, Shrinagar (Alaknanda), Goriganga	High dependence on Gas, availability uncertain
Jindal Power	9,020	-	9,020	-	-	Tamnar II, Dumka, Godda, Jharkhand, Bhubaneswar (JSPL)	Tamner to be operational by 2013; Coal availability adequate
JP Power	11,790	-	8,090	-	3,700	Bina, Karchana, Bara, Kannur, Nigrie, Karcham Wangtoo, Lower Siang (JV with State)	Karchana project stalled due to land issues; Other thermal projects will have staggered completion from 2013-14
JSW	10,530	-	5,890	4,400	240	Raigarh, Salboni, Baranda, Ratnagiri I & II, Barmer I & II, Kutehr	High dependence on merchant as well as imported coal.
Konaseema	820	820	-	-	-		Erratic gas supplies have affected the operational & under-construction plant
KSK Energy	6,113	-	5,983	-	130	Arasmeta II, Wardha Warora, Mahanadi, Wardha Naini, Dibbin	Company has linkages but not from Coal India hence availability uncertain.
Lanco	7,184	742	5,040	600	802	Amarkantak III & IV, Vidarbha Thermal, Anpara I, Udupi Power I & II, Babandh I, Kondapalli III, Vamshi I & II, Budhil, Green Power, Teesta, Uttaranchal I & II	Fuel availability to improve post signing of FSAs for near term projects. However, gas based plant's fuel availability uncertain.
NCC	4,060	-	-	3,960	100	Machilipatnam, Srikakulam I, Srikakulam II, Sorang	Srikakulam project embroiled in environmental issues; Machilipatnam to be completed by 2015
Reliance Power	20,760	5,200	15,060	4,000	1,700	Rosa II, Butibori, Chitrangi (CPPL), Tilaiya, Krishnapatnam, Sasan, Tato II, Siyom	Has captive mines for large projects. Krishnapatnam UMPP and gas based projects to likely to face issues
Sarda Energy	1,870	-	1,750	-	120	Raigarh I, Raigarh II, Ronghni, Gullu, Vishakapatnam	Under various stages of development
Sterlite Energy	6,240	-	6,240	-	-	Talwandi, Korba (Balco), Jharsuguda	Jharsuguda barely breaking even due to non-availability of coal
Tata Power	7,964	-	2,250	5,600	114	Maithon (JV with DVC), Naraj Marthapur, Mundra (CGPL), Dehrand I, Dagacchu (JV with Bhutan)	Mundra plant likely to incur losses, unless tariffs are revised. Long term projects have lesser visibility.
Torrent Power	3,883	1,882	2,000	-	-	Morga (JV with GMDC), Pipavav, Sugen I & II	Limited gas availability could delay full scale commencement of Sugen plant

Source: I-Sec research, Media reports

PFC: Various hues in the loan book, not all red

First, 85% of PFC's loans as of Mar-11 are towards states with unbundled SEBs where liabilities are clearly demarcated between generation companies (gencos), distribution companies (discoms) and transmission companies (transcos). The losses within unbundled SEBs lie primarily in the discoms making funding to gencos relatively safe. However, gencos also depend on discoms for their cashflow, hence discoms' distress will turn into constrained cashflow for gencos. Nevertheless, gencos are still seeing relatively better inflows given their healthier financials and cost-plus pricing, and PFC and REC are high on their repayment priority list along with NTPC, NHPC and CIL. We therefore feel a default will likely not arise in PFC's exposure to gencos, which account 84% of total loan book as of Dec-11.

Chart 7: PFC – Generation heavy loan book

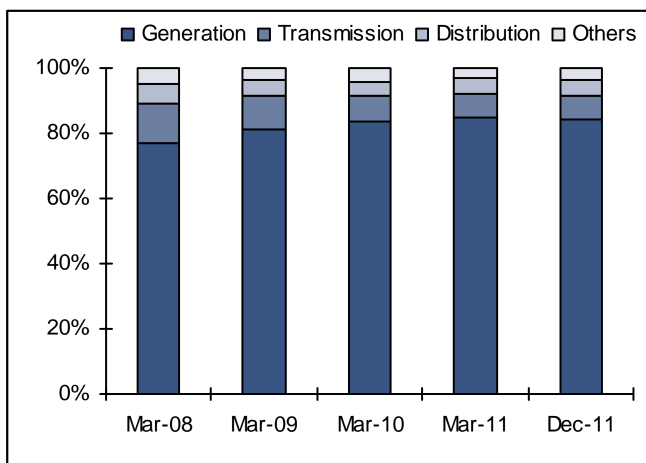
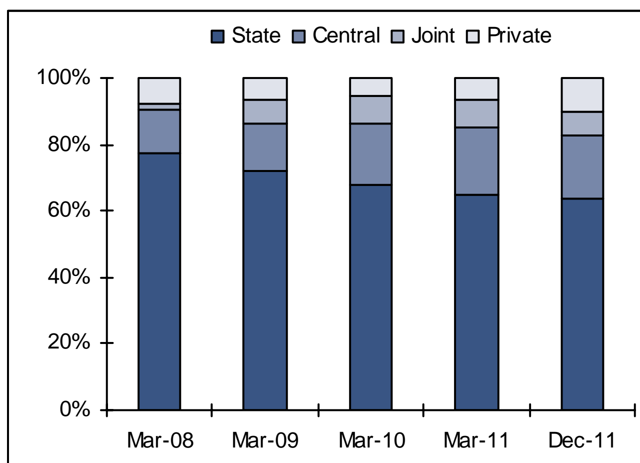


Chart 8: PFC – Declining exposure to state sector



Source: Company data, I-Sec research

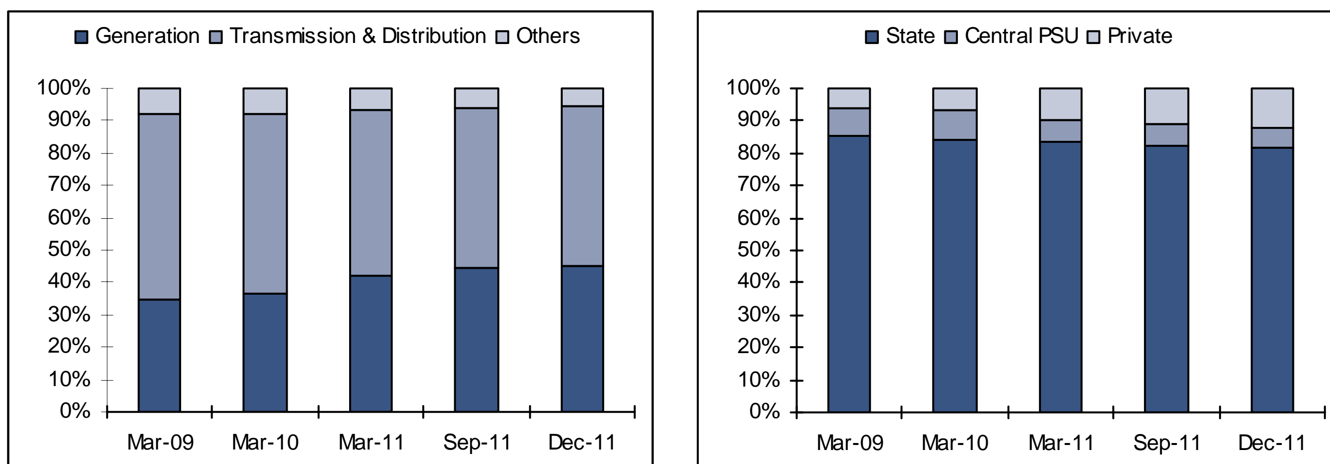
PFC's exposure to transmission & distribution at 12% of its loan book limits the first-order risks to a significantly smaller percentage of the book versus REC. Further, its outstanding working capital related loans to gencos are restricted to Rs30bn-40bn unlike banks, which are primary financiers of SEBs losses.

The key risk to PFC's asset quality, in our view, stems from the private sector where the exposures would be chunky and a 'bailout' unavailable. Not surprisingly, the NPAs that have already surfaced so far are from private sector projects.

REC: Riskier loan book given high T&D exposure

REC being the primary financer of the country's rural electrification drive has 49% of its overall loan book as of Dec-11 in the transmission & distribution space. Risk stems from the fact that a large chunk of its state sector exposure is towards discoms. We perceive REC's asset book to be riskier than PFC's because: i) its exposure to states with bundled SEBs, where liabilities are not demarcated between the gencos and discoms, stands at 29% versus 15% for PFC as of Mar-11, and ii) its exposure to top-9 loss-making states (accounting for ~96% of total SEB losses) stands at 60% versus 49% for PFC as of Mar-11. However, we take comfort from the fact that as of Sep-11, 21% of REC's total loans are also backed with state guarantee and ~2.8% of its loans to gencos are for the RGGVY which will likely be converted into a state/central government grant.

Chart 9: REC's loan mix heavy on T&D exposure, while private sector exposure has increased of late



Source: Company data, I-Sec research

REC's generation loan book witnessed strong growth post-2007 and the proportion of generation projects increased from 26% in FY08 to 45% in Dec'11. This was also accompanied by an increase in the proportion of private sector lending from 3.8% to 12% over the same period. Private projects, and specifically under-construction projects, which have been facing problems with fuel linkages, environmental clearances and power purchase agreement (PPA) face viability issues, remain the key risk to REC's asset quality.

Table 3: REC's loan book bears higher risk, relatively more comfort with PFC

State	Net worth as of FY10 (Rs mn)	PFC exposure (Mar-11)		REC exposure (Mar-11)	
		Amount (Rs mn)	% of total loans	Amount (Rs mn)	% of total loans
Maharashtra	95,720	118,352	12.8	138,857	17.0
Rajasthan	74,090	80,825	8.8	89,654	11.0
Haryana	11,070	78,780	8.6	52,951	6.5
Andhra Pradesh	58,310	78,072	8.5	85,009	10.4
Uttar Pradesh	91,310	74,183	8.1	68,866	8.4
West Bengal	83,020	74,077	8.0	52,369	6.4
Madhya Pradesh	(17,090)	67,944	7.4	20,661	2.5
Delhi	44,060	63,297	6.9	-	0
Uttarakhand	(5,980)	40,078	4.4	24,774	3.0
Gujarat	108,070	37,782	4.1	2,899	0.4
Chhattisgarh	32,670	37,518	4.1	22,737	2.8
Others	62,460	29,781	3.2	20,434	2.5
Total unbundled	637,710	**780,689**	**84.7**	**579,211**	**70.9**
Tamil Nadu	(227,280)	51,790	5.6	110,420	13.5
Jharkhand	(53,590)	28,511	3.1	15,534	1.9
Himachal Pradesh	(1,110)	26,476	2.9	14,536	1.8
Jammu & Kashmir	(99,270)	12,029	1.3	6,430	0.8
Arunachal	(7,200)	5,617	0.6	936	0.1
Sikkim	-	4,038	0.4	19,349	2.4
Tripura	(1,630)	3,743	0.4	129	0.0
Punjab	(68,280)	3,709	0.4	55,710	6.8
Others	(32,360)	4,581	0.5	14,827	1.8
Total bundled	(490,720)	**140,494**	**15.3**	**237,871**	**29.1**

Source: Company data, I-Sec research, PFC report on State Power Utilities

Business momentum to drive healthy earnings

Strong sanctions pipeline and further opportunities in power sector under the XIIth Five Year Plan will ensure steady loan growth. We expect 19% and 18% CAGR in loan growth and stable spreads at ~2.4% and 3.3% over FY12-14E respectively to drive earnings CAGR of 20% and 18% over FY12-14E for PFC and REC respectively.

Sanction pipeline robust, downside risks to growth remain

The 11th Five-Year Plan (FY07-12) envisaged capacity addition of 78.7GW of which only ~50GW is expected to be realised as near-term challenges emerged. Nevertheless, the long-term outlook for investments in the sector remains bright with the 12th Five-Year Plan (FY13-17) targeting a capacity creation of 100GW (of which 28GW will be from projects supposed to be completed in the 11th Plan period). We note that in the 9th and 10th Five-Year Plan periods, the actual capacity addition stood at 47% and 51% of the planned addition while in the 11th Plan period the capacity addition is much higher at 64% of the planned 78.7GW. Even at 50% of the planned capacity addition, it would be reasonable to expect funding requirement for 50GW or ~Rs2.5tn over the next five years.

In an increasingly import-dependent and power-deficit economy, power capacity additions are imperative for growth. Therefore, incremental project sanctions will likely drive ~18-20% YoY growth in disbursements from both PFC and REC. The current sanction pipeline is robust with PFC's outstanding sanctions at Rs1,820bn of which disbursements have commenced for Rs864bn worth of projects. Comparable numbers for REC are ~Rs1300bn and ~Rs600bn respectively. We expect this pipeline to translate into a loan CAGR of 19% for PFC and 18.0% for REC over FY12-14E.

However, in the event that coal capacity additions do not happen at the desired pace, or distribution reforms do not take place, the 12th Plan targets can get derailed and provide downside to our growth expectations.

Chart 10: PFC – Loan book to grow at CAGR of 19% over FY12-14E

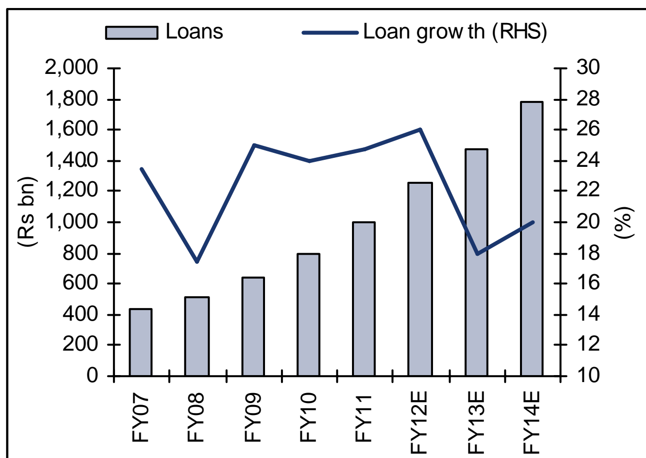
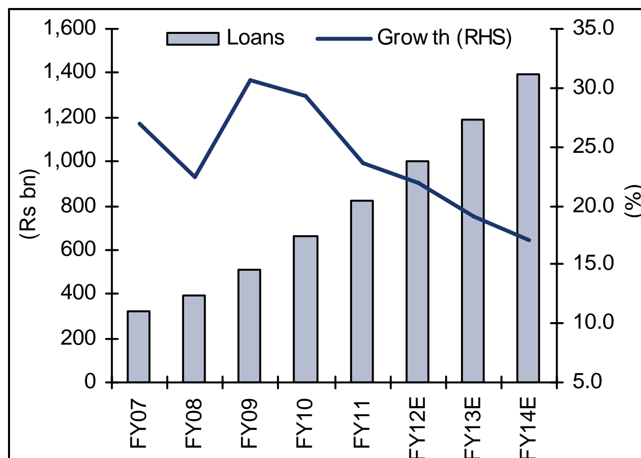


Chart 11: REC – Healthy disbursement to translate to loan CAGR of 18% over FY12-14E

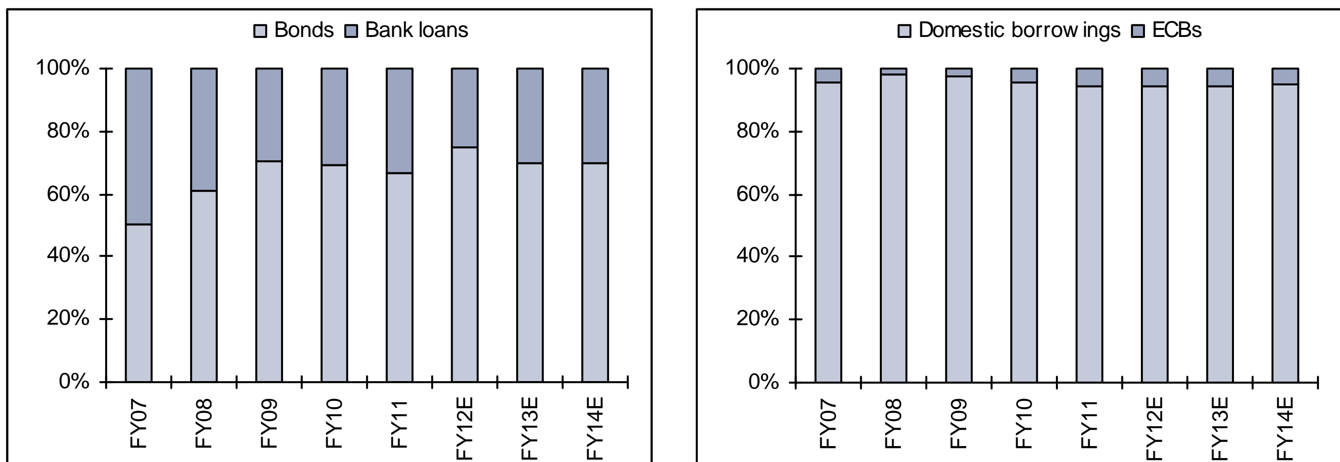


Source: Company data, I-Sec research

Borrowing profile well diversified, costs to trend lower

Institutional bonds and bank borrowings remain the primary source of funding for PFC. As of Dec'11, bank borrowings and institutional bonds form 25% and 75% of the company's total borrowings respectively. Post acquiring IFC status in 2010, proportion of foreign currency borrowings by PFC has gradually increased to 6% as of Dec'11. This proportion is set to increase as the company has an RBI approval for raising US$1bn via offshore medium-term notes. An IFC can raise ECBs to the tune of 50% of its net worth and 50% of that can remain unhedged. As of Dec'11, the outstanding ECB amount stands at 29% of net worth, of which 85% is unhedged. This leaves PFC with headroom of ~Rs44.4bn for increasing its ECBs.

Chart 12: PFC – Bonds dominate borrowing mix, headroom available in ECBs

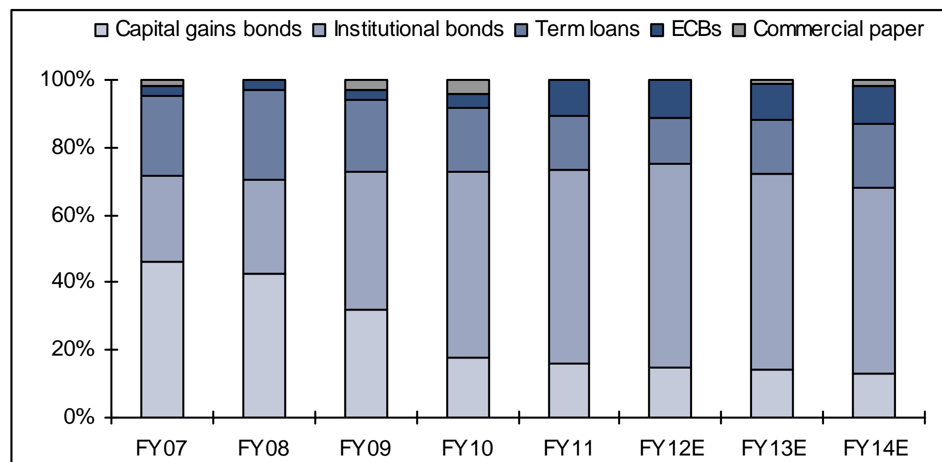


Source: Company data, I-Sec research

REC's capital gains exempt bonds have further diversified its borrowings compared to PFC and lowered costs. Decline in proportion of capital gain bonds from 46% in FY07 to 16% as of Dec'11 was somewhat compensated by increase in the proportion of ECBs from 3% in FY07 to 12% as of Dec'11. Outstanding ECBs form 66% of REC's net worth, leaving little room for incremental borrowing. We expect the liability mix to remain stable over FY12-14E.

Proportion of capital gains bonds have declined steadily while that of ECBs has increased over FY07-11

Chart 13: REC – Well diversified borrowing profile

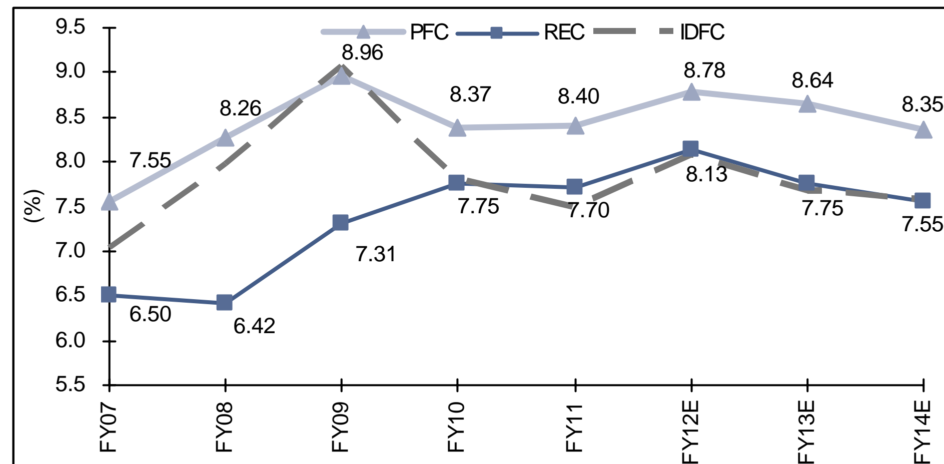


Source: Company data, I-Sec research

Historically, REC has enjoyed lower cost of funds as compared to PFC (*chart 14*) on account of higher proportion of capital gain exempt bonds and ECBs. Both these instruments have significantly lower costs when compared to the current wholesale borrowing rates of 9-9.5%. Capital gain bonds are issued with coupon rate at ~6% while costs of foreign borrowings currently stand at ~7.5% (hedged) and 5-5.5% (unhedged). PFC cannot issue capital gain bonds and thus ECBs (which account for 6% of its total borrowings) remain the sole option for low-cost funding.

REC has enjoyed cost advantages on account of higher proportion of low-cost funds – capital gain bonds and ECBs

Chart 14: Well diversified borrowing profile gives REC the cost advantage



Source: Company data, I-Sec research

Going ahead, mobilization of capital gain bonds for REC will continue to remain at ~Rs50bn per year, and result in gradual decline in its proportion to overall borrowings. Share of ECBs in total borrowings will likely increase for PFC while it will remain steady for REC. Though we expect the differential in cost of borrowings to continue, a declining interest rate environment would lower cost of funds to 8.4% and 7.6% for PFC and REC respectively by FY14E (from 9.1% and 8.4% as of Q3FY12 respectively).

Forex impact cushioned by regulation; remains a risk nevertheless

While adverse currency movements can result in MTM losses on unhedged exposures, the recent change in AS11 allowing amortisation of such losses over the residual maturity of the asset will limit the impact of sharp currency movements on earnings. As of Q3FY12, PFC and REC have 85% and 10% of their foreign exposure unhedged and should have taken further MTM hit as the currency depreciated 8.4% in Q3FY12. Nevertheless, the regulation led to a large write-back of exchange losses from H1FY12.

We think PFC runs a high exchange rate risk as ~85% of its ECBs are un-hedged. We agree with IDFCs approach where all forex loans are hedged. Given the limited balance sheet provisions for PFC / REC, forex positions, irrespective of accounting policy relaxations, should be conservative.

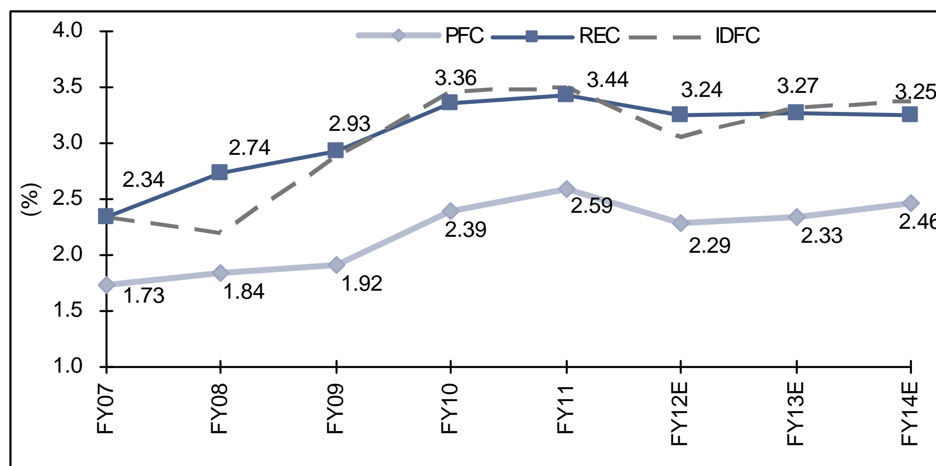
Spreads to sustain at healthy levels

Rising interest rates have increased cost of borrowings, more so for PFC than REC and resulted in relatively sharper spread compression over the past 12 months. On a YoY basis, spreads declined 58bps for PFC to 2.15% and 40bps for REC to 3.04% as of Q3FY12.

Going ahead, we expect cost of borrowings to decline on the back of softening interest rates, issuance of tax-free bonds and infrastructure bonds and increased proportion of foreign borrowings. This would help spreads stabilise at ~2.5% for PFC and ~3.3% for REC by FY14E.

Reversal of the interest rate cycle will reduce cost of borrowing and ensure stable-to-improving spreads for PFC and REC over FY12-14E

Chart 15: Spreads to stabilise going ahead



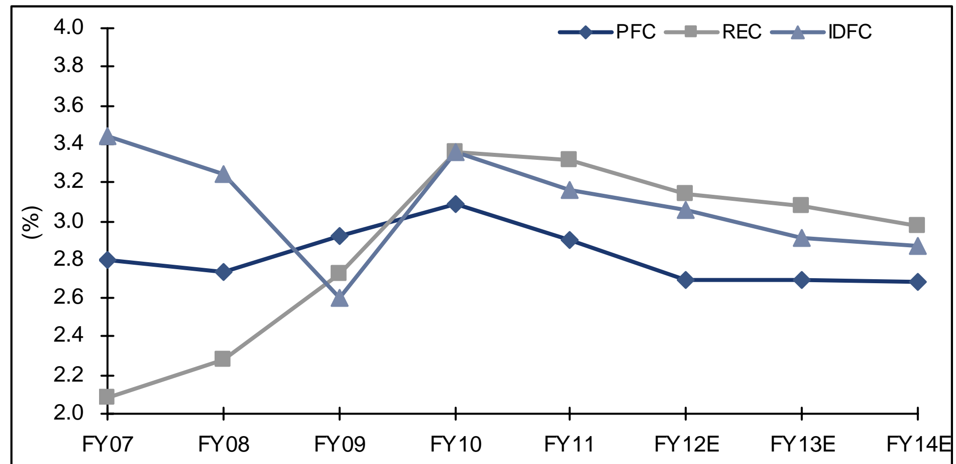
Source: Company data, I-Sec research

In sum, earnings growth and profitability will remain healthy

Given a healthy loan CAGR and stable spreads, we expect that earnings will continue to be fairly robust. We have built-in earnings CAGR of 20% over FY12-14E for PFC and 18% over FY12-14E for REC. This already incorporates slightly higher loan-loss provisions. However, any large-scale default will likely produce downside to our earnings.

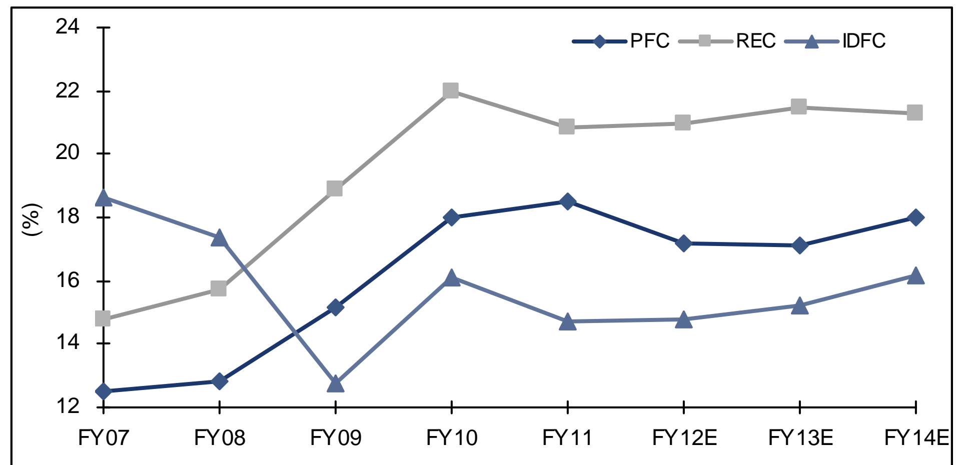
We estimate RoAs to continue at 2.7% and 3.1% over FY12-14E for PFC and REC respectively while healthy loan growth will increase leverage from current levels. Both PFC and REC are well-capitalised for 18-20% disbursements CAGR with current CAR at 17.9% and 17.4% respectively. Given the rise in leverage, RoEs (excluding extraordinary items) will trend towards 18% and 21.8% for PFC and REC respectively by FY14E. We do not anticipate any extraordinary variations in PAT (including extraordinary items) given the recent regulations that allow for amortising exchange gains/losses over the residual maturity of the bonds.

Chart 16: RoA for PFC is lower than peers, and results in …



Source: Company data, I-Sec Research

Chart 17: … subdued RoEs, borrowing mix change is *the* solution



Source: Company data, I-Sec Research

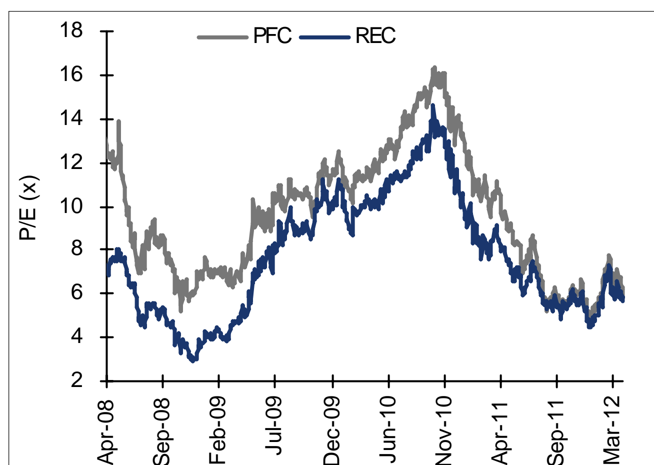
Play for re-rating on positive developments

Valuations of PFC and REC had declined sharply on a barrage of negative developments and then recovered on newsflow of positive steps by the PMO on coal availability. While policies addressing concerns will lead to near/medium-term upsides, structural re-rating in trading multiples, we believe, will manifest only upon successful and speedy implementation of the diktats. **Hence, we would attribute ~1.3x 12-month forward P/ABV multiple to both PFC & REC (sustainable RoE of 18% / 21%, earnings CAGR of 20% / 18% over FY12-14E respectively). At these multiples, current market prices offer 29% and 11% upside for PFC and REC respectively.**

Valuations and view

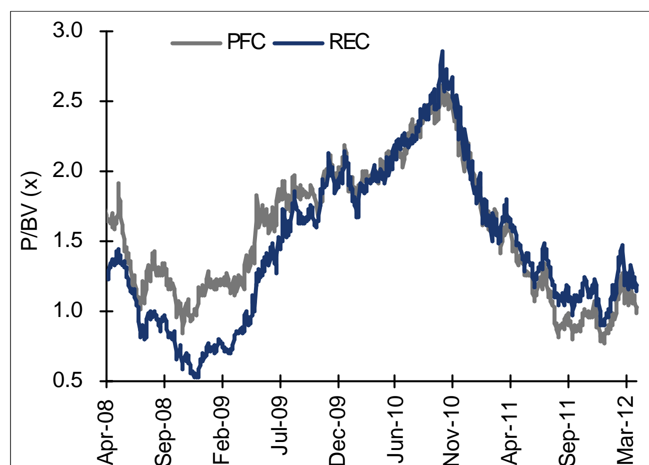
PFC's 5-year average P/ABV (12-month forward) multiple has been 1.6x while that for REC has been 1.5x. They currently trade at 1.1x and 1.2x respectively, which is fairly below their 5-year average trading range. Recent volatility in the stock performance has also been high, with PFC and REC grossly underperforming the broader indices (Chart 21).

Chart 18: Rolling 1-year forward P/E ratio



Source: Bloomberg, I-Sec research

Chart 19: Rolling 1-year forward P/ABV ratio

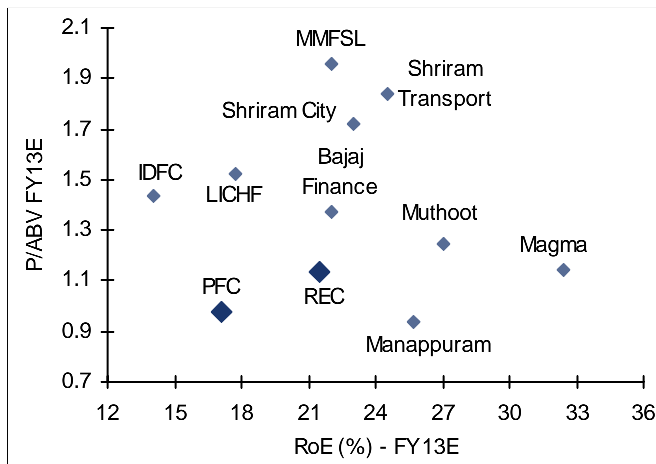


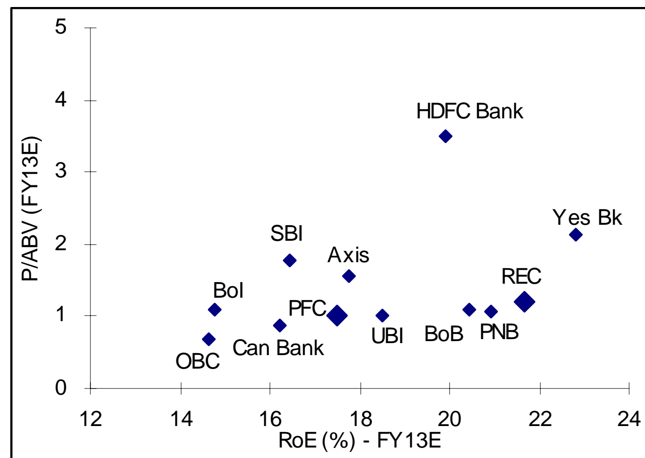
Source: Bloomberg, I-Sec research

We value PFC and REC on the single-stage Gordon Growth Model. We believe growth in disbursements will be relatively subdued over FY11-13E as various power projects are held up due to issues related to environmental clearance, fuel supply and land acquisition. Further, there is a natural gestation period between new project announcements and commencement of disbursements. However, we expect momentum to renew in FY14E as disbursements will pick-up. Ironically, significant project restructurings could turn out to be positive for loan growth!

Spreads will likely remain in the 2.4-3.3% range and recurring RoAs at 2.7-3.1% over FY12-14E. Accordingly, we ascribe fair values of 1.3x FY13E adjusted ABV to PFC and REC both. Given that PFC has a less risky asset book given its higher exposure to generation companies and to unbundled SEBs, we prefer PFC to REC for now.

Chart 20: Attractively priced vis-à-vis NBFC peers, at par with PSU banks but should re-rate higher

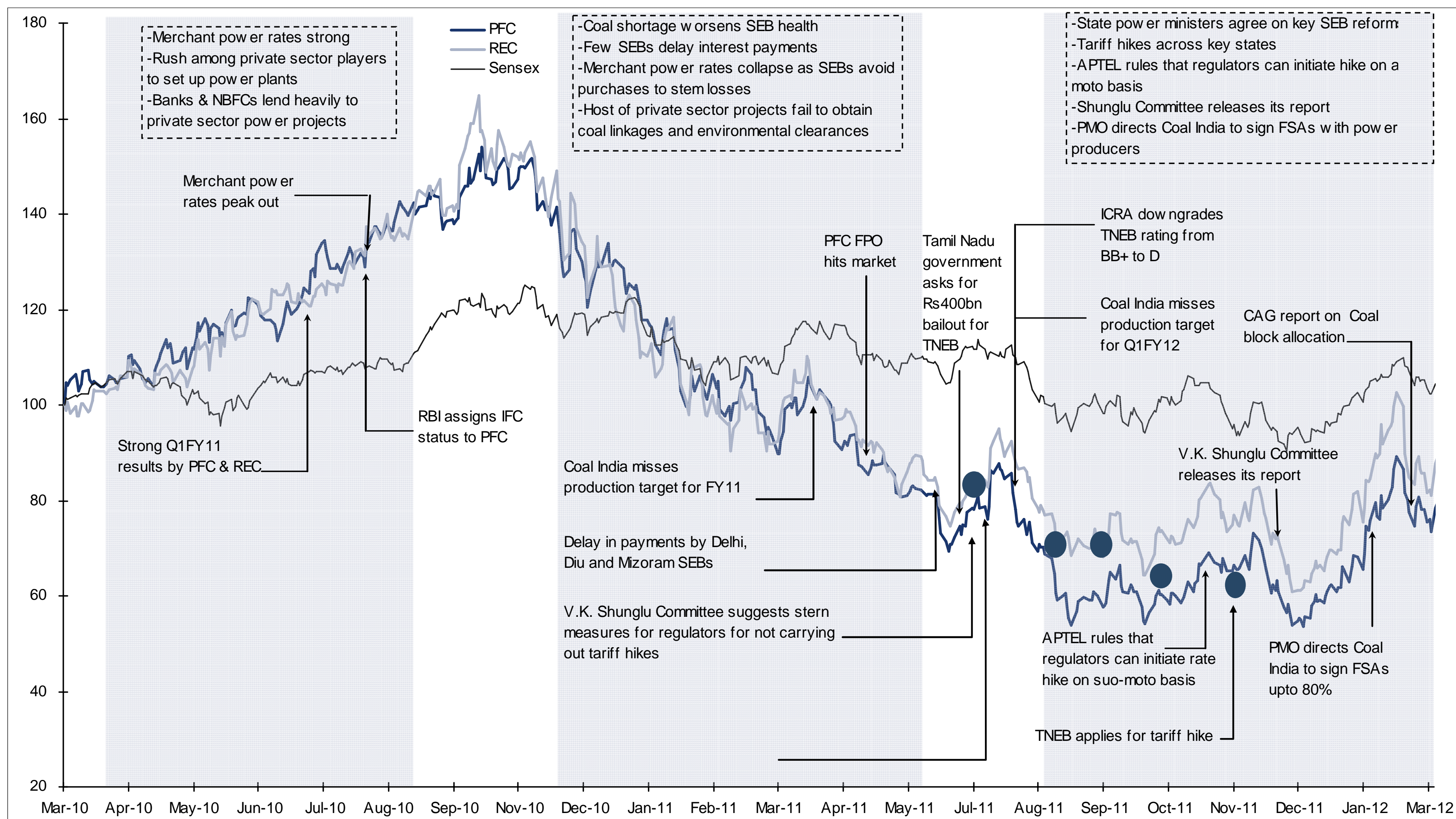




Note: Prices as on 28 Mar'12
Source: Bloomberg, I-Sec research

NBFCs such as Shriram Transport, Bajaj Finance, LIC Housing and IDFC trade at 1-year forward P/ABV of >1.5x despite having similar return profile as PFC and REC. Most public sector banks are currently trading at ~1x adjusted price-to-book-value. Considering their superior RoA profile, we believe current valuations at 1.0x and 1.2x FY13E ABV make PFC and REC reasonable bets, given the risks. We believe the valuations would catch up with their peers, once the reform process gains momentum.

Chart 21: Valuations have corrected with inflow of negative news, should re-rate gradually as reforms fructify



● indicates tariff hike by SEBs;
Note: Prices of Sensex, PFC and REC are rebased to 100
Source: Bloomberg, I-Sec research

Table 4: Chronology of events that affected PFC and REC

Phase	Events	Remark
Approach to heady valuations	• Strong demand-supply mismatch pushes up merchant power rates • Huge investments by private sector in power generation • Strong growth in sanctions by PFC and REC to private sector players • IFC status awarded to PFC and REC	• Expectations that PFC and REC would leverage their IFC status and experience high loan growth and robust profitability led to high valuations
Valuations crashed because	• Increasing problems in fuel availability with Coal India missing its production target and mining ban in 'no-go' areas • Accelerating pace of losses of SEBs on account of coal shortage • Delays in tariff hikes, inadequate hikes in key states • Crashing merchant power rates, failure to achieve coal linkages and environmental clearance led to fear of default by private players • Delay in interest payments by certain SEBs	• Moderated loan growth outlook and risk of elevated restructurings / NPAs led to crash in valuations
Valuations stabilise on regulatory actions	• Centre's refusal to bail out SEBs like TNEB and Rajasthan, effectively putting the onus of reform on states • APTEL order to grant suo moto powers to SERCs to raise tariffs • Adoption of 14-point agenda to improve viability of SEBs – a few states have also completed a draft roadmap for implementation • Major SEBs announced tariff hikes in CY11, few others like Tamil Nadu and Andhra Pradesh have petitioned for tariff hikes • V.K. Shunglu Committee recommended long-term solutions to improve financial health of SEBs and protect lenders from taking a hair-cut on the principal amount • PMO directs Coal India to sign FSA's to the tune of 80% with power producers	• Incrementally positive steps. • Attempt to cut red tape • Putting the onus of resolution on states • Indication that regulator / government is serious about a resolution
Potential threats looming around the corner	• CAG report on coal block allocation	• In case the report mentions reference on large scale illegal coal blocks, un-availability of coal would continue for longer than expected

Source: I-Sec research

V.K. Shunglu Committee report – Do not expect fast-track execution

Observations clearly indicate a large overhaul is required …

The V.K. Shunglu Committee report explicitly enumerates the various problems limiting the development of the power sector in India right from the grassroots level (where inefficiencies lie in collection, metering, measurement and resources) to governance and the merits and demerits of a franchise model versus a PPP-based approach. This indicates that a system overhaul is required – requiring huge capital expenditure (funded essentially by market borrowing, which aggravates fiscal deficit?) and effective leadership (given that most private players have limited management bandwidth, which poses a big challenge).

All other recommendations – i) need for independent functioning of regulating entities, ii) private participation in discoms, and iii) importance of having up-to-date accounts with MIS-based revenue and cost recognition to present a true picture of the financial status of SEBs – also give the feeling that deep-rooted and comprehensive reform is required. **In our view, this will take more than a Five-Year Plan period.**

…thus slowing resolution of issues, lengthy reform process ahead

Measures like minimum tariffs for agriculture consumers, pre-paid system for bulk customers (currently having poor payment history) and introduction of loss surcharge based on AT&C losses have political implications and would face resistance at regional levels. At best, these recommendations would be implemented only very gradually. Cashflows to the discoms would meaningfully improve only if these recommendations are widely accepted and sincerely implemented by the states. We think that the reform process will be long-drawn, and may not be completely resolved in the near future. **However, gradual implementation will continue, and valuations will reflect the same.**

What this means for term lending institutions

What are the implications of slow implementation of reforms on term lending institutions? Discoms will continue to accumulate losses even as the tariff burden on the consumer increases. This might lead to the second order effects of stress on gencos' cash flows too. The solution to this will likely be that part of the SEB advances are settled with the States, by debiting their accounts with the Centre. Further, lack of working capital funding will ensure that discoms work towards achieving at least operational break-even. In our view, in either case, there will be enormous pressure in the system to reform and hence, relevant authorities will Act.

SEB exposure more likely to be restructured, default unlikely

Our expectation that SEBs will not default is based on three observations: i) a default from SEBs will precipitate a contagion in the system, which will seriously undermine the creditworthiness of all sovereign-backed entities, and ii) financial pressures result in policy action, and iii) incremental finances will dry up in case improvement milestones are not achieved.

Over the past 6-9 months, coordinated action by regulators, lenders and state governments have resulted in 5-40% tariff hikes across various SEBs (table 1). Against this backdrop, measures like the V.K. Shunglu Committee recommendations and APTEL's order to grant suo moto powers to SERCs to raise tariff, if implemented, have the potential to improve SEBs' financial health in long term.

However, the implementation of the measures recommended by the V.K. Shunglu Committee could take long, and the accumulating losses in the interim will only pressurise finances. Tariff hikes may not be enough to cover even operational costs in the interim and commercial and technical losses will take time to be reigned in. This might necessitate some restructuring of loans, which would provide a moratorium in interest/principal servicing and marginally hit NPV.

Default/restructuring risk higher for IPPs as 'bailout' difficult

As for the private sector players, the clutch of projects announced over FY09-11, but still in the construction phase, have been experiencing delays on account of environmental clearances and inability to procure low-cost fuel. The PMO recently intervened to grant environmental clearances and has asked CIL to pool the cost of imported coal to level the playing field for all players. However, the implementation of this process itself is not clear, with various modalities still ambiguous. **In the meanwhile, we have already witnessed defaults across gas-, wind- and hydro-based projects for various reasons. We think the private sector projects will continue to face issues and some might slip into NPAs on account of various factors.** PFC and REC have relatively lower exposure to the private sector – the proportion is 10% and 12% respectively as in Dec'11. However, balance sheet provisions at 1.1% of loans for PFC and 0.7% of loans for REC as of Mar-11 are low. As of Dec-11, PFC has provisions of 0.9% of loans. Currently, REC is contemplating higher provisions for which discussions are at the board level.

Key risks

Haircut on principal outstanding could wipe out chunk of net worth

Drawing from the previous SEB bailout in 2003 when gencos like NTPC were asked to take >50% haircuts on their principal outstanding, any haircuts on the same could wipe out a chunk of the power financiers' net worth. When viewed in the backdrop of the V.K. Shunglu Committee's observation that SEBs will be in no position to pay back their accumulated losses, the scene becomes ominous and raises concerns over the book value of the two IFCs covered in this report, viz., PFC and REC.

While it is easy to assume that a certain percentage of loans will not be paid back and will wipe out a chunk of their net worth, we think that a hit to net worth is an impractical 'solution' and will likely be avoided. Given that PFC and REC are niche financiers and together account for Rs1.9tn of the Rs5.5tn loaned to the power sector, they are systemically important to credit disbursements to the sector – especially since they are not restricted by borrower-wise disbursement norms to SEBs. A hit to net worth will warrant recapitalisation, which will have to come from government coffers again given the high shareholdings of 73.7% in PFC and 66.8% in REC. **It seems illogical to wipe out a huge chunk of these two companies' net worth and recapitalise it again through market borrowings.**

Prolonged power sector reform process

A prolonged reform process will mean increasing accumulated losses and further exacerbation of the sector's current problems. The sector needs speedy environmental and land acquisition clearances, production ramp-up at Coal India, and curtailment of transmission and distribution losses. Further, SEBs should increase tariffs regularly and adequately to at least cover incremental operational costs, at the same time addressing the main problem of AT&C losses at discoms. The pace of policy reform in the past does not inspire much confidence in speedy resolution of various issues afflicting the power sector. **This, in our view, is the key risk to our call.**

Unhedged foreign exchange liabilities pose a risk despite regulations

Table 5: Forex sensitivity for PFC/REC

	Forex liabilities in, Mar'11	Break-up of forex liabilities (Mar'11)		Value of unhedged forex liability in rupee terms (Rs mn)			
		Hedged	Unhedged	Mar'11	Sep'11	Dec'11	Mar'12
PFC							
USD (mn)	542	160	382	17,021	18,696	20,258	19,388
JPY (mn)	42,797	246	42,551	22,569	27,042	29,359	26,036
EURO (mn)	27	0	27	1,692	1,748	1,834	1,807
Total				41,282	47,486	51,450	47,230
REC							
USD (mn)	1,170	200	970	43,247	47,505	51,473	49,261
JPY (mn)	47,697	44,316	3381	1,793	2,149	2,333	2,069
EURO (mn)	59	59	0	0	0	0	0
Total				45,041	49,653	53,806	51,330

Note: Exchange rates as at the end of the quarter used for calculations; For Mar-12, values are as of 28th March 2012
Source: Company data, I-Sec research

Index of Tables and Charts

Tables

Table 1: State Electricity Boards* – Key financials as of FY10 5
Table 2: A snapshot of private power projects in India 7
Table 3: REC's loan book bears higher risk, relatively more comfort with PFC 10
Table 4: Chronology of events that affected PFC and REC 19
Table 5: Forex sensitivity for PFC/REC 22

Charts

Chart 1: State Electricity Boards losses are concentrated in discoms 3
Chart 2: States with high contribution to SEB losses 3
Chart 3: States with Top-9 loss making SEBs – PFC has lower exposure* 4
Chart 4: States with bundled SEBs – PFC has lower exposure* 4
Chart 5: Break-up of power projects (total = ~281GW) currently under-construction 6
Chart 6: Fuel based break-up of power projects currently under construction (total = ~137GW) for top 20 private players 6
Chart 7: PFC – Generation heavy loan book 8
Chart 8: PFC – Declining exposure to state sector 8
Chart 9: REC's loan mix heavy on T&D exposure, while private sector exposure has increased of late 9
Chart 10: PFC – Loan book to grow at CAGR of 19% over FY12-14E 11
Chart 11: REC – Healthy disbursement to translate to loan CAGR of 18% over FY12-14E 11
Chart 12: PFC – Bonds dominate borrowing mix, headroom available in ECBs 12
Chart 13: REC – Well diversified borrowing profile 12
Chart 14: Well diversified borrowing profile gives REC the cost advantage 13
Chart 15: Spreads to stabilise going ahead 14
Chart 16: RoA for PFC is lower than peers, and results in … 15
Chart 17: … subdued RoEs, borrowing mix change is *the* solution 15
Chart 18: Rolling 1-year forward P/E ratio 16
Chart 19: Rolling 1-year forward P/ABV ratio 16
Chart 20: Attractively priced vis-à-vis NBFC peers, at par with PSU banks but should re-rate higher 17
Chart 21: Valuations have corrected with inflow of negative news, should re-rate gradually as reforms fructify 18

This page has been intentionally left blank

Equity Research
March 29, 2012
BSE Sensex: 17122

Power Finance Corporation

BUY

On higher ground

Rs172

Reason for report: Initiating coverage

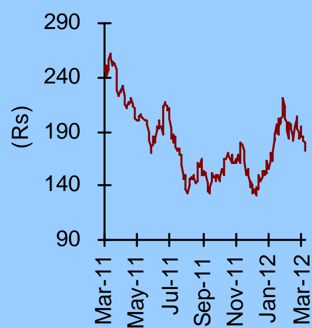
Target price Rs222

Shareholding pattern

	Jun '11	Sep '11	Dec '11
Promoters	73.7	73.7	73.7
Institutional investors	15.2	16.6	17.0
MFs and UTI	6.5	7.2	5.9
Insurance Cos.	2.7	2.9	3.4
FIIs	6.0	6.5	7.7
Others	11.1	9.7	9.3

Source: NSE

Price chart



We initiate coverage on Power Finance Corporation (PFC) with a BUY rating and target price of Rs222/share (1.3x FY13E ABV). This is a play on incremental improvements in the power sector that would lead to a valuation re-rating. PFC's lending profile is less risky compared to REC's on account of the former's lower exposure to discoms. While partial restructuring at some SEBs remains a possibility, a key risk emanates from its exposure to private power developers, which currently comprises 9.8% of loans and where 'bailout' has low probability. Despite factoring-in moderate loan growth, flat-to-declining spreads and higher loan-loss provisions, PFC's RoA and RoE is expected to remain healthy at 2.7% and 18% respectively over FY12-14E. Initiate with a BUY rating. Slower than expected pace of reforms leading to large-scale default and inability on part of private power players to acquire fuel linkages remain the key risks.

- **Sanction pipeline will fructify into healthy loan growth.** We expect strong investments in generation space over the 12th five year plan to benefit PFC's loan growth. A strong sanctions pipeline of Rs1.82tn with Rs864bn from projects where disbursements have commenced and documentation is complete will spur disbursements and drive loan book growth of 19% CAGR over FY12-14E.
- **Spreads to stabilise at current levels as borrowing costs decline.** On a YoY basis, spreads compressed 58bps to 2.15% in Q3FY12 as incremental borrowing costs remain high at ~9%. We expect spreads to recover to 2.5% by FY14E as declining interest rate environment lowers borrowing cost and cushions the impact of declining yields and ECB funding increases.
- **Asset quality concerns more on private sector exposure.** As recommended by VK Shunglu committee report, we believe that SEB restructuring would involve a hair-cut only on the interest rate. As such, we compress yields by ~30bps over FY12-14E. Also, we shall remain watchful of the private sector exposure, as delinquencies here could result in substantial downside risk.
- **Risk-reward attractive; BUY for re-rating.** The stock has underperformed the Nifty and Bankex by 22% and 18% YoY and is 52% below its lifetime high. However, recent government actions and tariff hikes highlight the fact that improvements will likely follow. The stock should hence re-rate. We initiate coverage with a Buy rating and a target price of Rs222/share (1.3x FY13E ABV).

Market Cap	Rs197.4bn/US$3.9bn
Reuters/Bloomberg	PWFC.BO/POWF IN
Shares Outstanding (mn)	1319.9
52-week Range (Rs)	261/132
Free Float (%)	26.3
FII (%)	7.7
Daily Volume (US$/'000)	25,096
Absolute Return 3m (%)	25.6
Absolute Return 12m (%)	(30.1)
Sensex Return 3m (%)	10.2
Sensex Return 12m (%)	(10.5)

Year to March	2011	2012E	2013E	2014E
NII (Rs mn)	36,679	43,428	52,962	62,979
Net Profit (Rs mn)	26,197	28,801	35,577	42,463
EPS (Rs)*	23.1	23.3	28.4	33.6
% Chg YoY	17.4	1.2	21.6	18.4
P/E (x)	7.5	7.4	6.1	5.1
P/BV (x)	1.3	1.1	1.0	0.9
Net NPA (%)	0.20	0.47	0.37	0.29
Dividend Yield (%)	2.9	3.5	4.1	4.7
RoA (%)*	2.9	2.7	2.7	2.7
RoE (%)*	18.7	17.2	17.1	18.0

* EPS, RoA and RoE are calculated on recurring profits

Abhishek Murarka
abhishek.murarka@icicisecurities.com
+91 22 6637 7351
Shashin Upadhyay
shashin.upadhyay@icicisecurities.com
+91 22 6637 7572
Digant Haria
digant.haria@icicisecurities.com
+91 22 6637 7314

PFC: A play on generation space

Historically, generation projects have dominated PFC's lending book as its exposures to the segment grew from 77% of the loan-book in FY08 to 84% in Dec'11. During the same period, PFC's exposure to the state sector (SEBs) declined from 77% in FY08 to 63% in Dec'11 as it increased lending to the joint and private sectors. The power sector attracted huge investments from private players over FY07-11 and PFC's exposure to them increased from 7.5% in FY08 to 9.8% in Dec'11.

Chart 1: Lending profile (segment-wise)

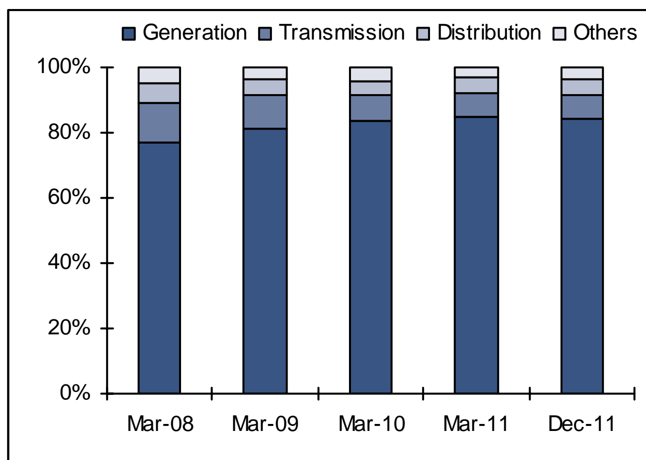
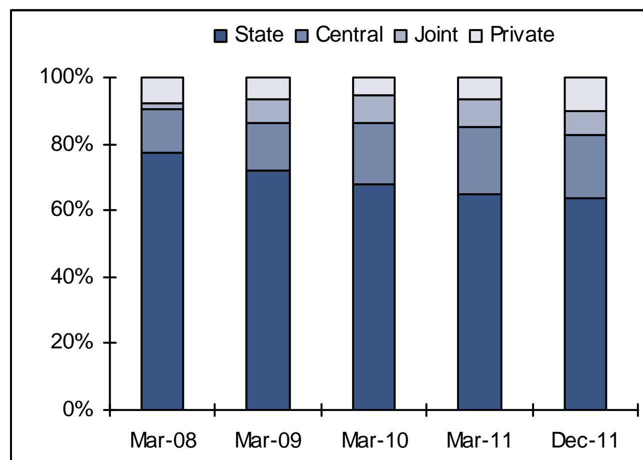


Chart 2: Lending profile (end-user-wise)



Source: RBI, I-Sec research

As of Sep'11, PFC's exposure to SEBs stands at ~Rs709bn or 64% of its loan-book, of which ~Rs140bn or 13% of loan book is guaranteed by state governments. While exposure to states with bundled SEBs is relatively low at 15% of the loan-book, a majority of the exposure is towards generation projects where cashflows are relatively good and collateral value is ~1.6x the loan value. Private sector projects-under-construction account for ~5% of the total loan-book as of Sep-11 and remain a concern.

Despite the current bottlenecks, the long-term outlook for investments in the power sector remain bright with the draft 12th Five-Year Plan targeting a capacity creation of 100GW (of which 28GW will be from projects supposed to be completed under the 11th Plan). Strong domain expertise, established relationships and diversified liability profile will help PFC benefit from rising investments in the power sector. Sanctions pipeline for PFC remains strong with outstanding sanctions at Rs1,820bn, of which disbursements have commenced for Rs864bn worth of projects. We estimate this to likely translate into 19% loan CAGR over FY12-14E.

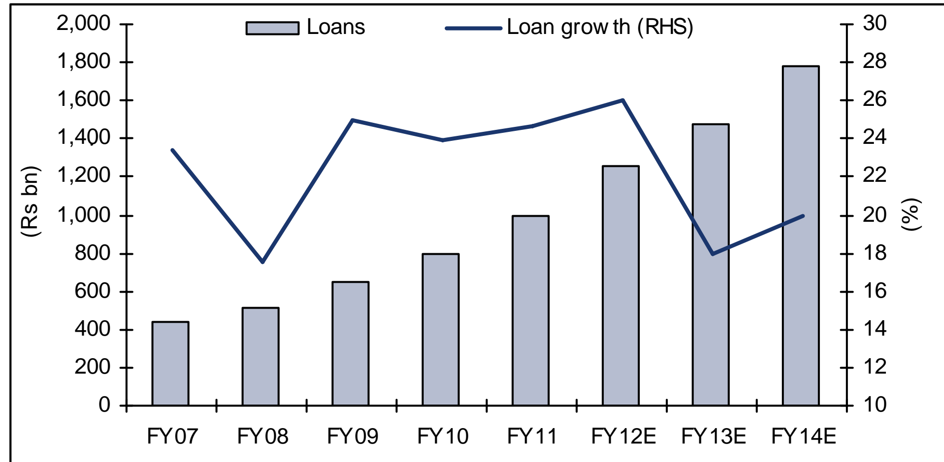
Table 1: Projects under stress

Project	Exposure (Rs mn)	Reason for slippage
Shree Maheshwar	7,000	Will likely be classified as NPA in Q4FY12. Project is under implementation and facing funding delays as promoter is unable to infuse further equity
Konaseema	3,950	Lack of gas supply and tariff dispute with Andhra Pradesh discom
MP based wind project	2,300	Variation in wind patterns led to problems, although the project could be upgraded in near future

Source: Company data, I-Sec research

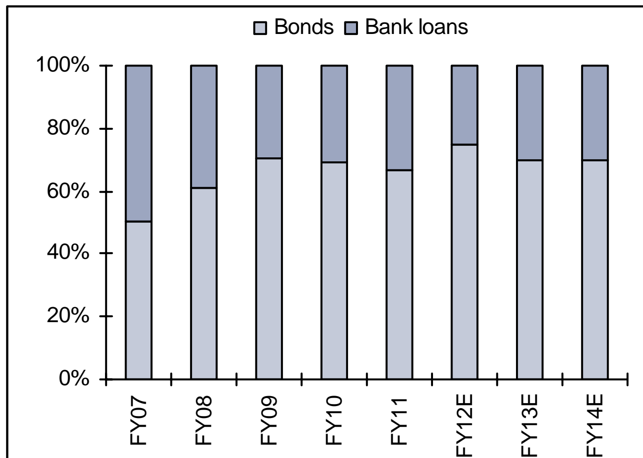
Healthy sanctions pipeline at Rs1,820bn will translate in 19% loan CAGR over FY12-14E

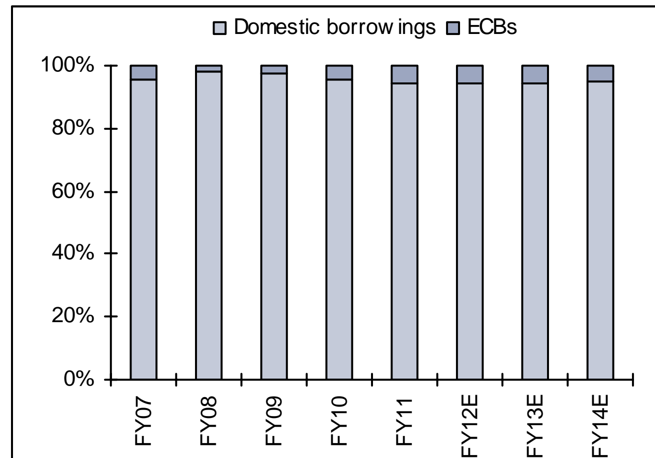
Chart 3: We expect loan growth to remain robust



Source: Bank data, I-Sec research

Chart 4: Borrowing profile —heavily dependent on domestic funding, low on ECBs

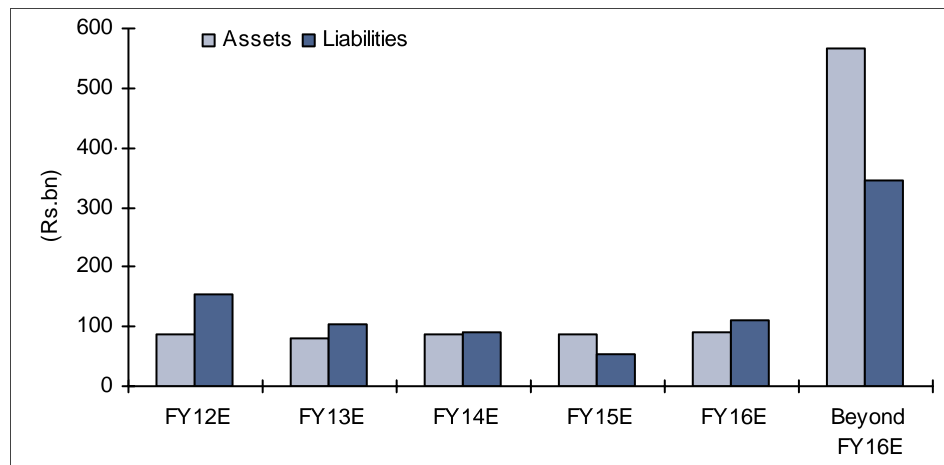




Source: RBI, I-Sec research

The ALM profile remains well matched, with majority of assets and liabilities maturing beyond FY16E

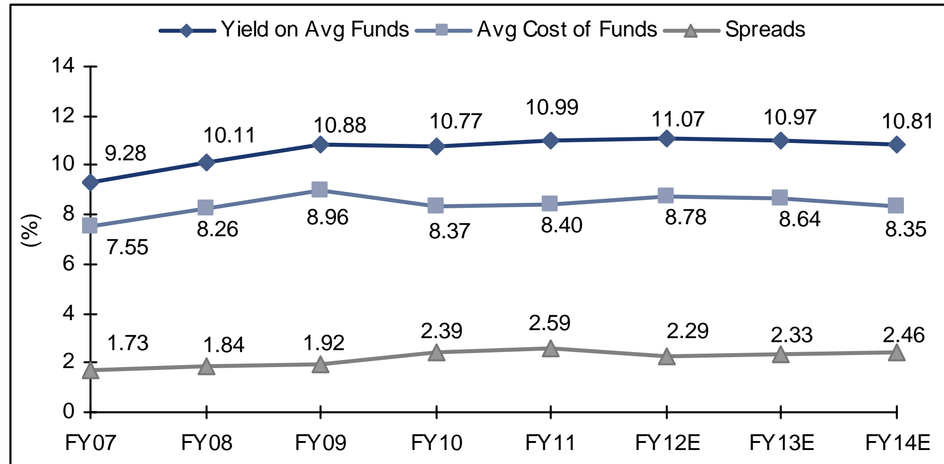
Chart 5: Asset - liability maturity (ALM) profile – March 2011



Source: Bloomberg, I-Sec research

Instituting hedging of overseas borrowings will allow PFC to raise more ECBs and lower its costs. This should aid spreads.

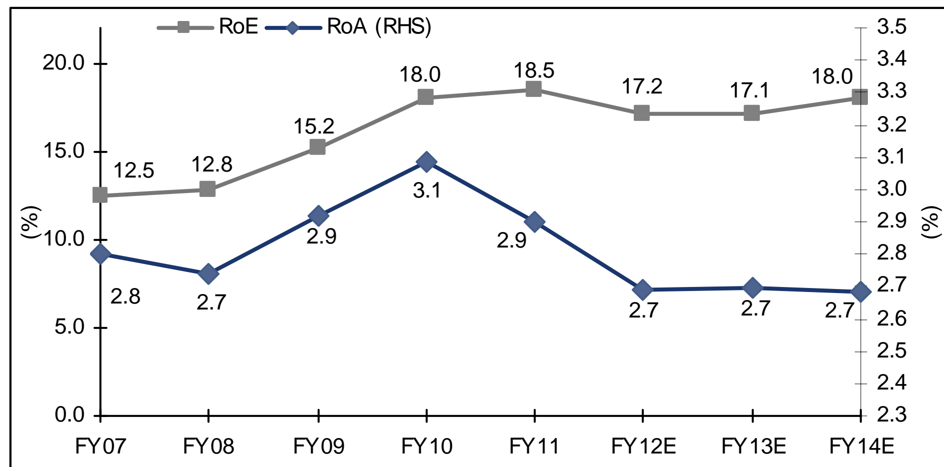
Chart 6: Spreads likely to recover as borrowing diversifies



Source: Bloomberg, I-Sec research

We estimate RoAs to remain at 2.7% over FY12-14E and drive RoEs at 17-18% over the period

Chart 7: Rising leverage will push up RoEs, RoAs healthy



Source: Bloomberg, I-Sec research

Valuation methodology and key risks

We initiate coverage on PFC with a **BUY** rating and a target multiple of 1.3x FY13E ABV, which translates into a target price of Rs222/share. The key risks of our call are slowdown in the SEB reform process and inability of private sector projects to obtain coal linkages or re-negotiate power purchase agreements.

Chart 8: P/E ratio below average

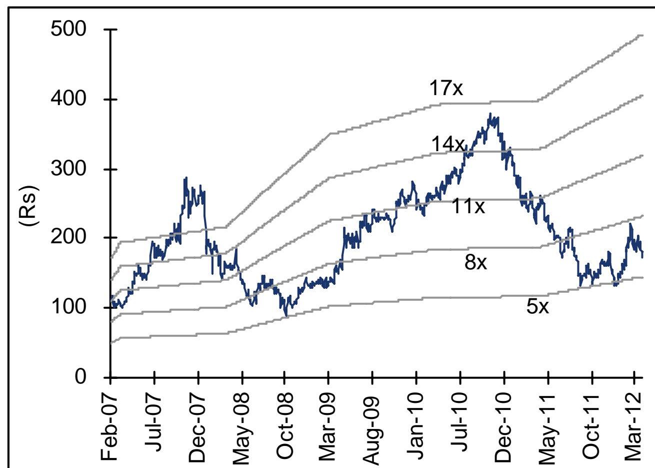
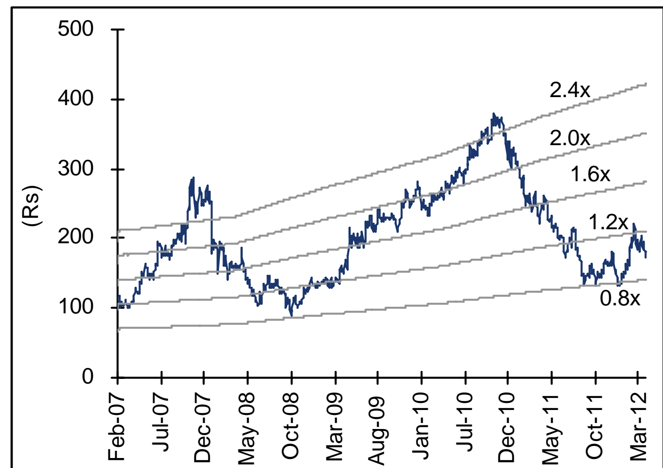


Chart 9: Price/BV ratio at average levels



Source: I-Sec research

Company description

PFC was set up on 16th July 1986 as a Financial Institution (FI) dedicated to Power Sector financing and committed to the integrated development of the power and associated sectors. It was awarded the status of Infrastructure Finance Company in July 2010. Since inception, it has disbursed loans worth Rs1,985bn and has an outstanding loan book of Rs1,179bn as of Dec 2011. PFC's product portfolio comprise of Project Term Loan, Equipment Lease Financing, Discounting of Bills, Short Term Loan, and Consultancy Services etc. for various Power projects in Generation, Transmission, and Distribution sector as well as for Renovation & Modernization of existing power projects. In addition to financing, PFC also provides technical, advisory and consultancy services and related services through its subsidiary company PFC Consulting Limited. It has also been appointed as a nodal agency for development of UMPPs and for operationalisation of the government's Restructured Accelerated Power Development and Reforms Programme (R-ARDRP).

Management profile

Mr. Satnam Singh (Chairman & Managing Director) is a management graduate from Punjab University and has over three decades of experience in the power and financial sectors. He was instrumental in implementation of the government of India's Ultra Mega Power Project (UMPP) and Restructured ARDRP plans. He provides strategic direction and guidance to all the activities of PFC.

Mr. M.K. Goel (Director-Commercial) holds a bachelor's degree in electrical engineering from Kanpur University and has been with the company since 1988. He is responsible for all the commercial functions of the company and oversees its HR, IT and legal activities.

Mr. R. Nagarajan (Director-Finance) is a qualified chartered accountant, cost accountant and a certified associate of the Indian Institute of Bankers. He looks after activities relating to resource mobilisation, disbursement, recovery, risk management, etc.

Table 2: Capital raising history

Date	Equity capital (Rs mn)	Reason	Premium (Rs/share)
23/09/1987	30.40	Equity shares issued	0
25/03/1988	130.40	Further Issue	0
7/11/1988	330.40	Further Issue	0
13/12/1989	630.40	Further Issue	0
25/02/1991	850.45	Further Issue	0
17/02/1992	975.45	Further Issue	0
1/9/1992	985.45	Further Issue	0
15/07/1994	1030.45	Further Issue	0
19/02/2007	1147.77	Public Issue	75
24/05/2011	1319.93	Public Issue - FPO	193

Source: Company data

Table 3: Board of directors

Satnam Singh	Chairman and Managing Director
M.K. Goel	Director (Commercial)
Rajeev Sharma	Director (Projects)
R. Nagarajan	Director (Finance)
Devender Singh	Director (Government Nominee)
Ravindra H. Dholakia	Independent Director
P.Murali Mohana Rao	Independent Director
S.C. Gupta	Independent Director
Ajit Prasad	Independent Director
Krishna Mohan Sahni	Independent Director

Source: Company data

Financial summary

Table 2: Profit and Loss statement

(Rs mn, year ending March 31)

	FY11	FY12E	FY13E	FY14E
Interest earned	101,285	128,182	154,136	180,339
Interest expended	64,606	84,754	101,174	117,360
Net interest income	**36,679**	**43,428**	**52,962**	**62,979**
Other income	321	362	417	521
Operating expenses	934	1,149	1,398	1,698
Employee costs	602	722	874	1,031
Pre-provisioning profit	**36,066**	**42,642**	**51,980**	**61,802**
Depreciation	43	50	60	71
Provisions & contingencies	317	685	967	997
Profit before tax	**35,706**	**41,906**	**50,953**	**60,734**
Income taxes	9,246	11,105	13,503	16,398
Extra-ordinary income/(expenses)	-	-	-	-
Prior period adjustments	-	-	-	-
Net profit (ex-forex gains / loss)	26,460	30,801	37,450	44,336
Exchange losses (+) or gains(-)	264	2000	1873	1873
Net profit (reported)	**26,197**	**28,801**	**35,577**	**42,463**

Source: Company data, I-Sec research

Table 3: Balance sheet

(Rs mn, year ending March 31)

	FY11	FY12E	FY13E	FY14E
Share Capital	11,478	13,199	13,199	13,199
Networth	152,654	206,347	231,114	261,222
Borrowings	855,986	1,066,039	1,267,618	1,534,636
Bonds	569,495	799,529	887,333	1,074,245
Loans	286,491	266,510	380,286	460,391
Interest subsidy fund from GOI	4,519	4,067	4,270	4,484
Total liabilities & stockholders' equity	**1,013,159**	**1,276,453**	**1,503,002**	**1,800,341**
Current Assets, Loans & Advances	49,330	57,349	61,615	66,791
Current liabilities and provisions	33,183	36,893	40,582	44,640
Net current assets	**16,146**	**20,456**	**21,032**	**22,150**
Investments	539	593	658	724
Advances	995,707	1,254,591	1,480,418	1,776,501
Fixed Assets, net	767	813	894	966
Total assets	**1,013,159**	**1,276,453**	**1,503,002**	**1,800,341**

Source: Company data, I-Sec research

Table 4: Key ratios

(Year ending March 31)

	FY11	FY12E	FY13E	FY14E
Per share data (Rs)				
Period end shares outstanding (mn)	1,147.8	1,319.9	1,319.9	1,319.9
Basic EPS*	23.1	23.3	28.4	33.6
Diluted EPS	23.1	23.3	28.4	33.6
Book value per share	133.0	156.3	175.1	197.9
Adjusted book value per share	131.3	151.9	171.0	194.1
Growth ratios (%)				
Total assets	25.0	26.0	17.7	19.8
Advances	24.7	26.0	18.0	20.0
Borrowings	27.6	24.5	18.9	21.1
Book value	14.7	17.5	12.0	13.0
EPS	17.4	1.2	21.6	18.4
Valuation ratios (x)				
P/PPP (pre-provisioning profit)	0.5	0.4	0.3	0.3
P/E	7.5	7.4	6.1	5.1
P/BV	1.3	1.1	1.0	0.9
P/ABV	1.3	1.1	1.0	0.9
Dividend yield (%)	2.9	3.5	4.1	4.7
Operating ratios (%)				
Operating cost to income	2.5	2.6	2.6	2.7
Operating expenses/ Avg. assets	0.1	0.1	0.1	0.1
Profitability ratios (%)				
Spread	2.6	2.3	2.3	2.5
NIM	4.0	3.7	3.8	3.8
Return on avg assets*	2.9	2.7	2.7	2.7
Return on avg net worth*	18.7	17.2	17.1	18.0
Asset quality and capital (%)				
Gross NPA	0.23	0.55	0.50	0.45
Net NPA	0.20	0.47	0.37	0.29
CAR	15.7	17.0	16.2	15.3

*EPS, RoA and RoE are calculated on recurring profits
Source: Company data, I-Sec research

Table 5: DuPont model

(Year ending March 31)

	FY11	FY12E	FY13E	FY14E
Interest earned	11.1	11.2	11.1	10.9
Interest expended	7.1	7.4	7.3	7.1
Gross Interest Spread	**4.0**	**3.8**	**3.8**	**3.8**
Provisioning for NPAs	0.0	0.1	0.1	0.1
Net Interest Spread	**4.0**	**3.7**	**3.7**	**3.8**
Operating cost	0.10	0.10	0.10	0.10
Lending spread	**3.9**	**3.6**	**3.6**	**3.6**
Fee based income	0.0	0.0	0.0	0.0
Operating spread	**3.9**	**3.7**	**3.7**	**3.7**
Tax	1.0	1.0	1.0	1.0
ROA (ex-forex gains)	**2.9**	**2.7**	**2.7**	**2.7**
Exchange losses (+) or gains(-)	0.0	0.2	0.1	0.1
ROA (reported)	**2.9**	**2.5**	**2.6**	**2.6**
Leverage	6.4	6.4	6.4	6.7
RoE	18.7	17.2	17.1	18.0

Source: Company data, I-Sec research

Equity Research
March 29, 2012
BSE Sensex: 17122

ICICI Securities

Rural Electrification Corporation

ADD

Vision clouded, mission clear

Rs195

Reason for report: Initiating coverage

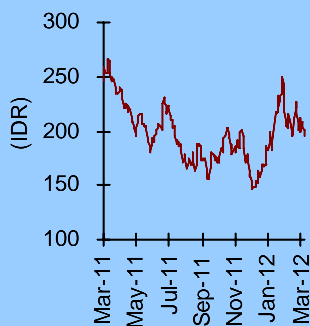
Target price Rs217

Shareholding pattern

	Jun '11	Sep '11	Dec '11
Promoters	66.8	66.8	66.8
Institutional investors	24.2	25.1	24.8
MFs and UTI	2.7	2.9	2.8
Insurance Cos.	2.5	3.7	4.1
FIIs	19.0	18.5	17.9
Others	9.0	8.1	8.4

Source: NSE

Price chart



We initiate coverage on Rural Electrification Corporation (REC) with a ADD rating and a target price of Rs217/share (1.3x FY13E ABV). We believe valuations at 1.2x FY13E adjusted book value and 5.7x FY13E EPS leave little upside, even as concerns about the utilities space are being addressed through coordinated efforts by the power ministry, CERC, state regulators and the RBI. However, we build in slightly higher loan loss provisions for FY12-FY14E, and remain watchful of its exposure to private sector. Despite this, 18% CAGR in loan growth and stable spreads will ensure RoEs at 21% over FY12-14E. Prolonged delay in the SEB reform process and private power projects turning unviable remain the key risks to our call.

- **Reforms to ensure revival in disbursements.** While lending to SEBs has slowed down over past six months, sanction pipeline remains strong at ~Rs1300bn as of Dec 2011 and will translate to strong disbursement growth once the reform process accelerates. Further, REC has been diversifying its loan book with higher disbursements to gencos which will aid future growth. We estimate a pick-up in disbursements to drive an overall loan book growth of 18% CAGR over FY12-14E.
- **Cost advantage to ensure healthy spreads.** A well diversified liability profile has helped REC control its borrowing costs and maintain its spread at +3% over FY09-9MFY12. Capital gains exempt bonds and ECBs, the major sources of low cost borrowings, constitute 16% and 12% of total borrowings as of Q3FY12. Going ahead, their proportion is likely to remain stable while declining interest rate environment will lower borrowing costs. Spreads would remain stable at 3.3% over FY12-14E.
- **Partial restructuring of SEBs possible; pressures likely from private sector.** REC has higher exposure to the distribution arms of SEBs and stressed SEBs could very well see some restructuring. As such, we build in yield compression of 55bps over FY12-14E to account for possible interest rate hair-cut. However, larger risk stems from its exposure to private sector.

Market Cap	Rs168.3bn/US$3.3bn
Reuters/Bloomberg	RURL.BO/RECL IN
Shares Outstanding (mn)	987.5
52-week Range (Rs)	267/148
Free Float (%)	33.2
FII (%)	17.9
Daily Volume (US$/'000)	20,301
Absolute Return 3m (%)	31.2
Absolute Return 12m (%)	(20.6)
Sensex Return 3m (%)	10.2
Sensex Return 12m (%)	(10.5)

Year to March	2011	2012E	2013E	2014E
NII (Rs mn)	35,239	41,190	48,649	56,376
Net Profit (Rs mn)	25,699	28,194	33,393	39,283
EPS (Rs)*	25.2	29.2	34.3	40.3
% Chg YoY	24.1	15.9	17.7	17.4
P/E (x)	7.8	6.7	5.7	4.9
P/BV (x)	1.5	1.3	1.1	1.0
Net NPA (%)	129.4	148.6	171.3	198.2
Dividend Yield (%)	3.8	4.1	4.8	5.6
RoA (%)*	3.3	3.1	3.1	3.1
RoE (%)*	20.8	21.0	21.5	21.8

* EPS, RoA and RoE are calculated on recurring profits

Abhishek Murarka
abhishek.murarka@icicisecurities.com
+91 22 6637 7351
Shashin Upadhyay
shashin.upadhyay@icicisecurities.com
+91 22 6637 7572
Digant Haria
digant.haria@icicisecurities.com
+91 22 6637 7314

Loan mix – incremental tilt towards generation/private sector

Although a dominant player in the transmission and distribution space, REC has gradually increased its exposure to generation projects from 26% in FY08 to 45% in Dec'11. This was also accompanied by an increase in proportion of private sector lending from 4% to 12% over the same period. Further, we note that the state sector still constitutes 82% of REC's total loan portfolio.

Chart 1: Lending profile (segment-wise)

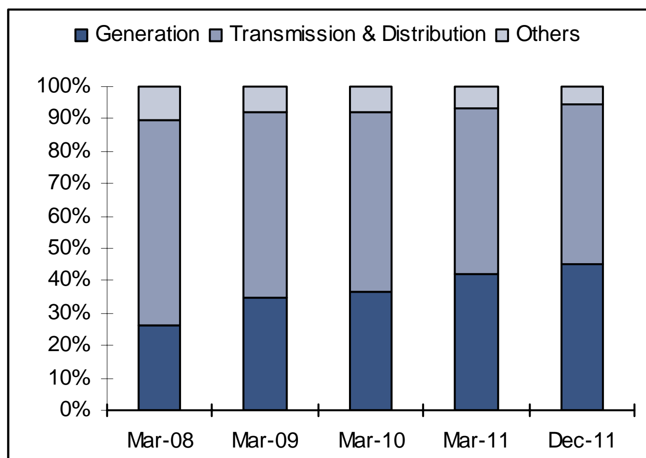
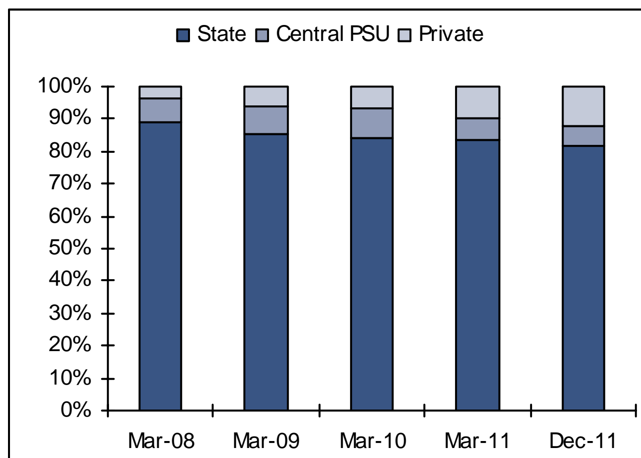


Chart 2: Lending profile (end-user-wise)



Source: RBI, I-Sec research

Risk to REC's loan portfolio emanates from its high exposure to the distribution arm of SEBs (Discoms). We note that as of Mar-11 1) RECs exposure to states with bundled SEBs is relatively higher at 29% vs 15% of loan book for PFC 2) Exposure to States with top 9 loss making SEBs is 60% (v/s 49% for PFC) and a major proportion of this is to discoms 3) Private power projects account for 12% of loan book. However, we take comfort from the fact that as of Sep-11; nearly 21.3% of its loan book (mostly SEB exposure) was backed with state guarantee and 3% of REC's generation loans are for the RGGVY, which will likely be converted into a State/Central Government grant.

The problems faced by the power sector in general and power financers in particular have resulted in strong, coordinated response from regulators. Although implementation of reforms process would be slow, the long term outlook for investments in power sector remains bright. The draft 12th five year plan targets a capacity creation of 100GW (of which 28GW will be from projects supposed to be completed under the 11th plan), which will result in huge investments in power generation space. This coupled with existing sanction pipeline of ~Rs1300bn should ensure 18% loan CAGR over FY12-14E.

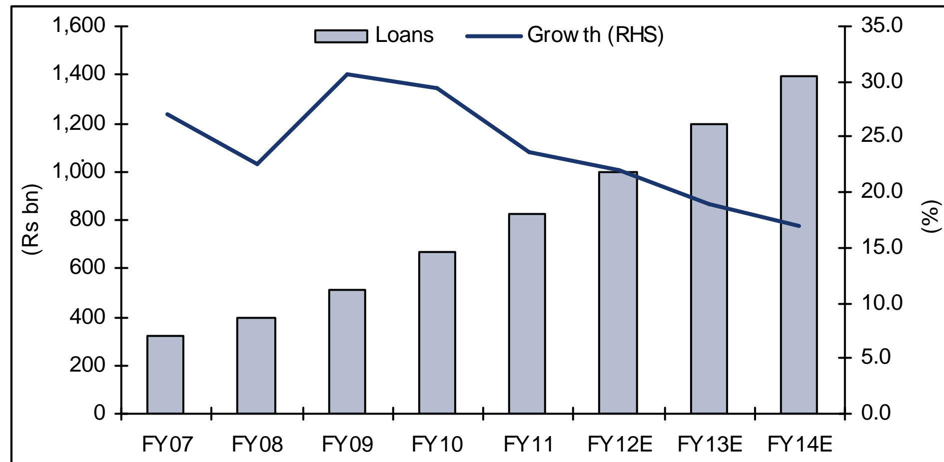
Table 1: Projects under stress

Project	Exposure (Rs mn)	Comment
Konaseema	2,300	Lack of gas supply and tariff dispute with Andhra Pradesh discom
MP based wind project	2,500	Variation in wind patterns led to problems, although the project could be upgraded in near future

Source: Company data, I-Sec research

We expect disbursements to pick up as the reform process gains momentum and lead to a loan CAGR of 18% over FY12-14E

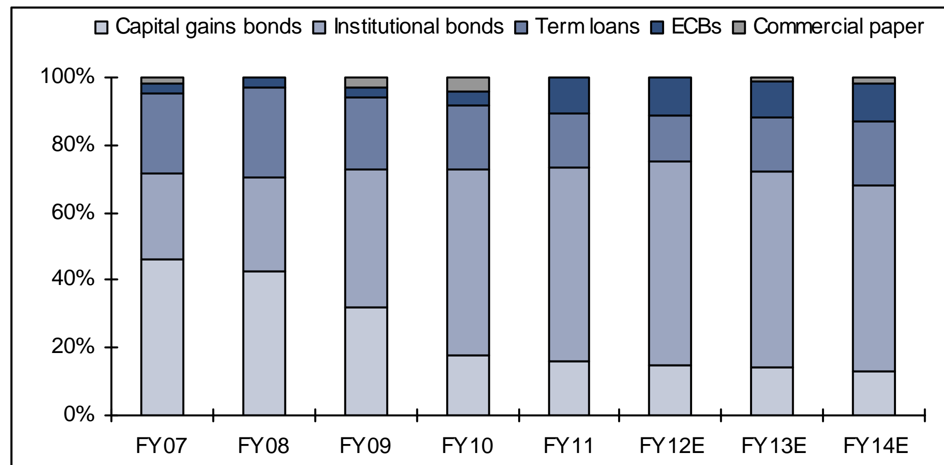
Chart 3: Strong sanctions pipeline to aid healthy loan growth over FY12-14E



Source: Company data, I-Sec research

Healthy mix of capital gains bonds and ECBs will ensure lower cost of borrowing for REC over FY12-14E

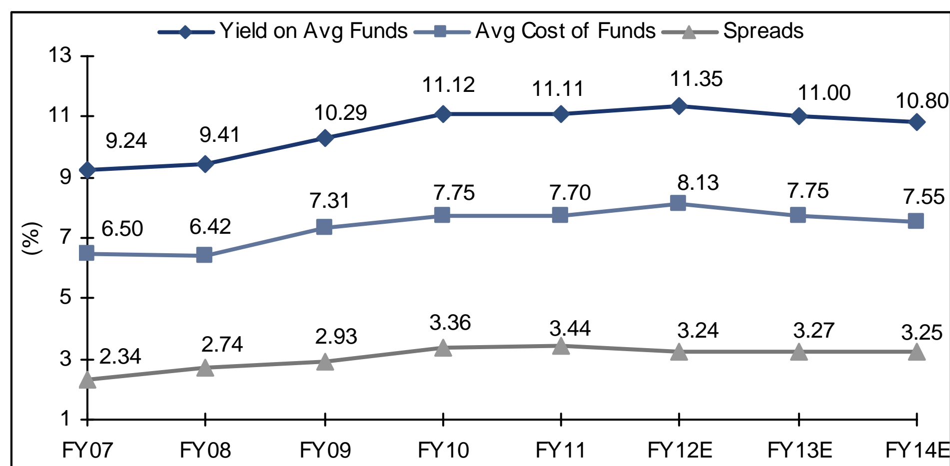
Chart 4: Well-diversified borrowing profile to keep borrowing costs low



Source: Company data, I-Sec research

We estimate declining borrowing costs to offset the impact of lower yields and result in stable spreads at 3.3% over FY12-14E

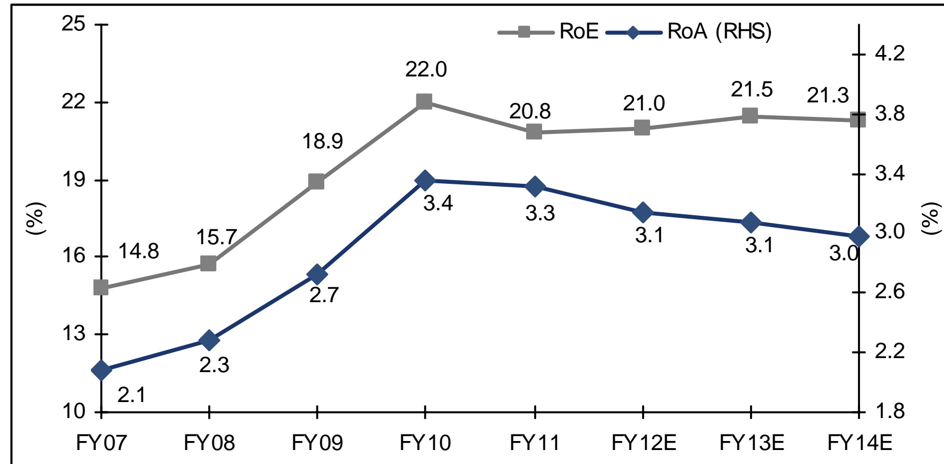
Chart 5: Spreads to remain at +3% over FY12-14E



Source: Company data, I-Sec research

Earnings CAGR at 18% over FY12-14E will ensure stable-to-improving return ratios for REC

Chart 6: Healthy return ratios likely to remain intact



Source: Company data, I-Sec research

Valuation methodology and key risks

We initiate coverage on REC with an **ADD** rating and a target multiple of 1.3x FY13E ABV, which translates into a target price of Rs217/share. Slowdown in the SEB reform process and inability on the part of private players to complete their on-going power plants remain the key risks of our call.

Chart 7: P/E ratio below 5-year average

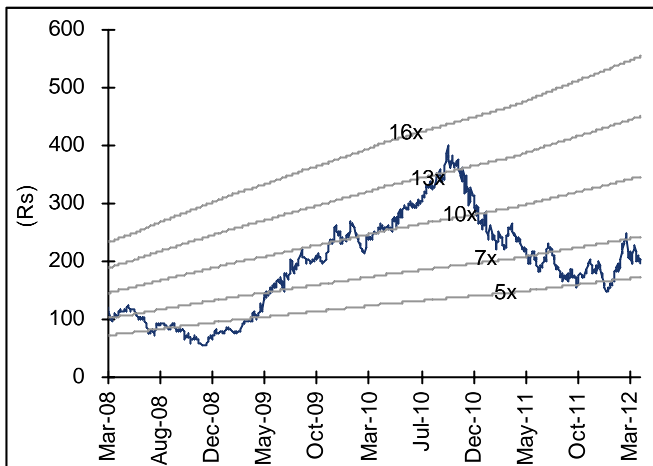
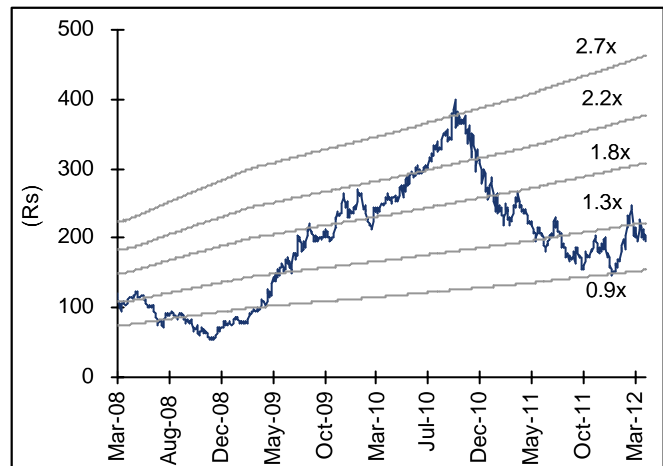


Chart 8: Price/BV ratio too below 5-year average



Source: I-Sec research

Company description

Rural Electrification Corporation Limited (REC), was incorporated on July 25, 1969 with the objective to finance and promote rural electrification projects all over the country. It provides financial assistance to State Electricity Boards, State Government Departments and electric cooperatives for rural electrification projects sponsored by them. It was awarded Infrastructure Finance Company status in 2010. It has a networth of Rs143bn and an outstanding loan portfolio of Rs953bn as of December 2011 spread across distribution & transmission (49%) and generation (45%) space. In the past few years, it has also started financing generation project in the private sector and its exposure to them stands at 12% as of December 2011.

Management profile

Mr. Rajeev Sharma (Chairman & Managing Director) holds a postgraduate diploma and a master's degree in engineering from IIT Roorkee and has over two decades of experience in the power sector. Prior to joining REC, he was Director (Projects) at Power Finance Corporation and was responsible for all functions of the projects division including technical appraisal of the projects financed by the company.

Mr. H.D. Khunteta (Director-Finance) holds a bachelor's degree from the University of Rajasthan and is an associate member of ICAI. He has over 33 years of experience in financial management. He is responsible for formulating financial strategies and supervises treasury functions, lending operations and corporate risk management.

Mr. P.J. Thakkar (Director-Technical) is an electrical engineer from Vadodara and has over 32 years of experience in the power sector including 15 years at the Power Grid Corporation of India. He is in charge of all technical and operational aspects of various projects financed by REC in the generation, transmission and distribution segments.

Table 2: Capital-raising history

Date	Equity capital (Rs mn)	Reason	Premium (Rs/share)
31/03/1997	5,830	As per corporate results	0
31/03/1998	6,310	Equity shares issued	0
31/03/1999	6,810	Equity shares issued	0
31/03/2001	7,306	Equity shares issued	0
31/03/2002	7,806	Loan conversion	0
5/3/2008	8,587	Public issue	95
5/3/2010	9,875	Public issue - FPO	203

Source: Company data

Table 3: Board of directors

Rajeev Sharma	Chairman and Managing Director
Hari Das Khunteta	Director (Finance)
Prakash Thakkar	Director (Technical)
Devendra Singh	Director (Government Nominee)
Devi Singh (Dr.)	Independent Director
Govinda Marapalli Rao (Dr.)	Independent Director
Venkataraman Subramanian	Independent Director

Source: Company data

Financial summary

Table 2: Profit and Loss statement

(Rs mn, year ending March 31)

	FY11	FY12E	FY13E	FY14E
Interest earned	83,749	104,614	121,825	140,655
Interest expended	48,510	63,424	73,176	84,279
Net interest income	**35,239**	**41,190**	**48,649**	**56,376**
Other income	350	472	614	749
Operating expenses	1,644	1,906	2,283	2,626
Employee costs	1,275	1,555	1,866	2,146
Pre-provisioning profit	**33,946**	**39,757**	**46,980**	**54,500**
Depreciation	30	30	40	50
Provision for bad & doubtful debt	2	551	835	698
Profit before tax	33,913	39,175	46,105	53,752
Income taxes	9,067	10,381	12,218	13,976
Minority Interest	-	-	-	-
Net profit (ex-forex gains / loss)	**24,846**	**28,794**	**33,887**	**39,777**
Exchange losses (+) or gains(-)	(853)	600	494	494
Net profit	**25,699**	**28,194**	**33,393**	**39,283**

Source: Company data, I-Sec research

Table 3: Balance sheet

(Rs mn, year ending March 31)

	FY11	FY12E	FY13E	FY14E
Share Capital	9,875	9,875	9,875	9,875
Reserves and surplus	118,012	136,963	159,380	185,954
Deferred tax liability	(128)	(128)	(128)	(128)
Borrowings	700,038	860,213	1,028,200	1,204,348
Total liabilities & stockholders' equity	**827,797**	**1,006,923**	**1,197,327**	**1,400,049**
Fixed Assets, net	652	913	1,142	1,313
Investments & Capital work-in-progress	8,352	7,935	8,252	8,665
Net current assets	(2,529)	(3,936)	(4,460)	(5,029)
Advances	821,321	1,002,011	1,192,393	1,395,100
Total assets	**827,797**	**1,006,923**	**1,197,327**	**1,400,049**

Source: Company data, I-Sec research

Table 4: Key ratios

(Year ending March 31)

	FY11	FY12E	FY13E	FY14E
Per share data (Rs)				
Period end shares outstanding (mn)	987.5	987.5	987.5	987.5
Basic EPS*	25.2	29.2	34.3	40.3
Diluted EPS	25.2	29.2	34.3	40.3
Book value per share	129.4	148.6	171.3	198.2
Adjusted book value per share	129.4	143.8	166.7	193.8
Growth ratios (%)				
Advances	23.6	22.0	19.0	17.0
Borrowings	25.1	22.9	19.5	17.1
Book value	15.4	14.8	15.3	15.7
EPS	24.1	15.9	17.7	17.4
Valuation ratios (x)				
P/PPP (pre-provisioning profit)	5.7	4.9	4.1	3.6
P/E	7.8	6.7	5.7	4.9
P/BV	1.5	1.3	1.1	1.0
P/ABV	1.5	1.4	1.2	1.0
Dividend yield (%)	3.8	4.1	4.8	5.6
Operating ratios (%)				
Operating cost to income	4.6	4.6	4.6	4.6
Operating expenses/ Avg. assets	0.2	0.2	0.2	0.2
Profitability ratios (%)				
Spread	3.4	3.2	3.3	3.3
Net interest margin	4.6	4.3	4.3	4.2
Return on avg. assets*	3.3	3.1	3.1	3.1
Return on avg net worth*	20.8	21.0	21.5	21.8
Asset quality and capital (%)				
Gross NPA	0.02	0.46	0.43	0.40
Net NPA	0.00	0.47	0.20	0.15
CAR	19.1	17.0	16.6	15.9

*EPS, RoA and RoE are calculated on recurring profits
Source: Company data, I-Sec research

Table 5: DuPont model

(Year ending March 31)

	FY11	FY12E	FY13E	FY14E
Interest earned	11.2	11.4	11.1	10.8
Interest expended	6.5	6.9	6.6	6.5
Gross Interest Spread	**4.7**	**4.5**	**4.4**	**4.3**
Provisioning for NPAs	0.0	0.1	0.1	0.1
Net Interest Spread	**4.7**	**4.4**	**4.3**	**4.3**
Operating cost	0.2	0.2	0.2	0.2
Lending spread	**4.5**	**4.2**	**4.1**	**4.1**
Fee based income	0.0	0.1	0.1	0.1
Operating spread	**4.5**	**4.3**	**4.2**	**4.1**
Tax	1.2	1.1	1.1	1.1
ROA (ex-forex gains)	**3.3**	**3.1**	**3.1**	**3.1**
Exchange loss (+) or gains (-)	(0.1)	0.1	0.0	0.0
ROA (reported)	**3.4**	**3.1**	**3.0**	**3.0**
Effective leverage	6.3	6.7	7.0	7.1
RoE	**20.8**	**21.0**	**21.5**	**21.8**

Source: Company data, I-Sec research

This report may be distributed in Singapore by ICICI Securities, Inc. (Singapore branch). Any recipients of this report in Singapore should contact ICICI Securities, Inc. (Singapore branch) in respect of any matters arising from, or in connection with, this report. The contact details of ICIC Securities, Inc. (Singapore branch) are as follows: Address: 30 Cecil Street #15-29 Prudential Tower, Singapore 049712, Tel: +65 6232 2451 and email: ashvin_patil@icicisecuritiesinc.com, Rishi_agrawal@icicisecuritiesinc.com.

New I-Sec investment ratings (all ratings based on absolute return)
BUY: >15% return; ADD: 5% to 15% return; REDUCE: Negative5% to positive5% return; SELL: < negative 5% return

ANALYST CERTIFICATION

We /I, *Abhishek Murarka, PGDM, MBA (Finance); Shashin Upadhyay, MBA; Digant Haria, MBA* research analysts and the authors of this report, hereby certify that all of the views expressed in this research report accurately reflect our personal views about any and all of the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report. Analysts aren't registered as research analysts by FINRA and might not be an associated person of the ICICI Securities Inc

Disclosures:

ICICI Securities Limited (ICICI Securities) and its affiliates are a full-service, integrated investment banking, investment management and brokerage and financing group. We along with affiliates are leading underwriter of securities and participate in virtually all securities trading markets in India. We and our affiliates have investment banking and other business relationship with a significant percentage of companies covered by our Investment Research Department. Our research professionals provide important input into our investment banking and other business selection processes. ICICI Securities generally prohibits its analysts, persons reporting to analysts and their dependent family members from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover.

The information and opinions in this report have been prepared by ICICI Securities and are subject to change without any notice. The report and information contained herein is strictly confidential and meant solely for the selected recipient and may not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of ICICI Securities. While we would endeavour to update the information herein on reasonable basis, ICICI Securities, its subsidiaries and associated companies, their directors and employees (“ICICI Securities and affiliates”) are under no obligation to update or keep the information current. Also, there may be regulatory, compliance or other reasons that may prevent ICICI Securities from doing so. Non-rated securities indicate that rating on a particular security has been suspended temporarily and such suspension is in compliance with applicable regulations and/or ICICI Securities policies, in circumstances where ICICI Securities is acting in an advisory capacity to this company, or in certain other circumstances.

This report is based on information obtained from public sources and sources believed to be reliable, but no independent verification has been made nor is its accuracy or completeness guaranteed. This report and information herein is solely for informational purpose and may not be used or considered as an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments. Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. ICICI Securities will not treat recipients as customers by virtue of their receiving this report. Nothing in this report constitutes investment, legal, accounting and tax advice or a representation that any investment or strategy is suitable or appropriate to your specific circumstances. The securities discussed and opinions expressed in this report may not be suitable for all investors, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific recipient. This may not be taken in substitution for the exercise of independent judgement by any recipient. The recipient should independently evaluate the investment risks. The value and return of investment may vary because of changes in interest rates, foreign exchange rates or any other reason. ICICI Securities and affiliates accept no liabilities for any loss or damage of any kind arising out of the use of this report. Past performance is not necessarily a guide to future performance. Actual results may differ materially from those set forth in projections. Forward-looking statements are not predictions and may be subject to change without notice.

ICICI Securities and its affiliates might have managed or co-managed a public offering for the subject company in the preceding twelve months. ICICI Securities and affiliates might have received compensation from the companies mentioned in the report during the period preceding twelve months from the date of this report for services in respect of public offerings, corporate finance, investment banking or other advisory services in a merger or specific transaction. It is confirmed that *Abhishek Murarka, PGDM, MBA (Finance); Shashin Upadhyay, MBA; Digant Haria, MBA* research analysts and the authors of this report have not received any compensation from the companies mentioned in the report in the preceding twelve months. Our research professionals are paid in part based on the profitability of ICICI Securities, which include earnings from Investment Banking and other business.

ICICI Securities or its subsidiaries collectively do not own 1 or more of the equity securities of the Company mentioned in the report as of the last day of the month preceding the publication of the research report.

It is confirmed that *Abhishek Murarka, PGDM, MBA (Finance); Shashin Upadhyay, MBA; Digant Haria, MBA* research analysts and the authors of this report or any of their family members does not serve as an officer, director or advisory board member of the companies mentioned in the report.

ICICI Securities may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report. ICICI Securities and affiliates may act upon or make use of information contained in the report prior to the publication thereof.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject ICICI Securities and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

This report has not been prepared by ICICI Securities, Inc. However, ICICI Securities, Inc. has reviewed the report and, in so far as it includes current or historical information, it is believed to be reliable, although its accuracy and completeness cannot be guaranteed.